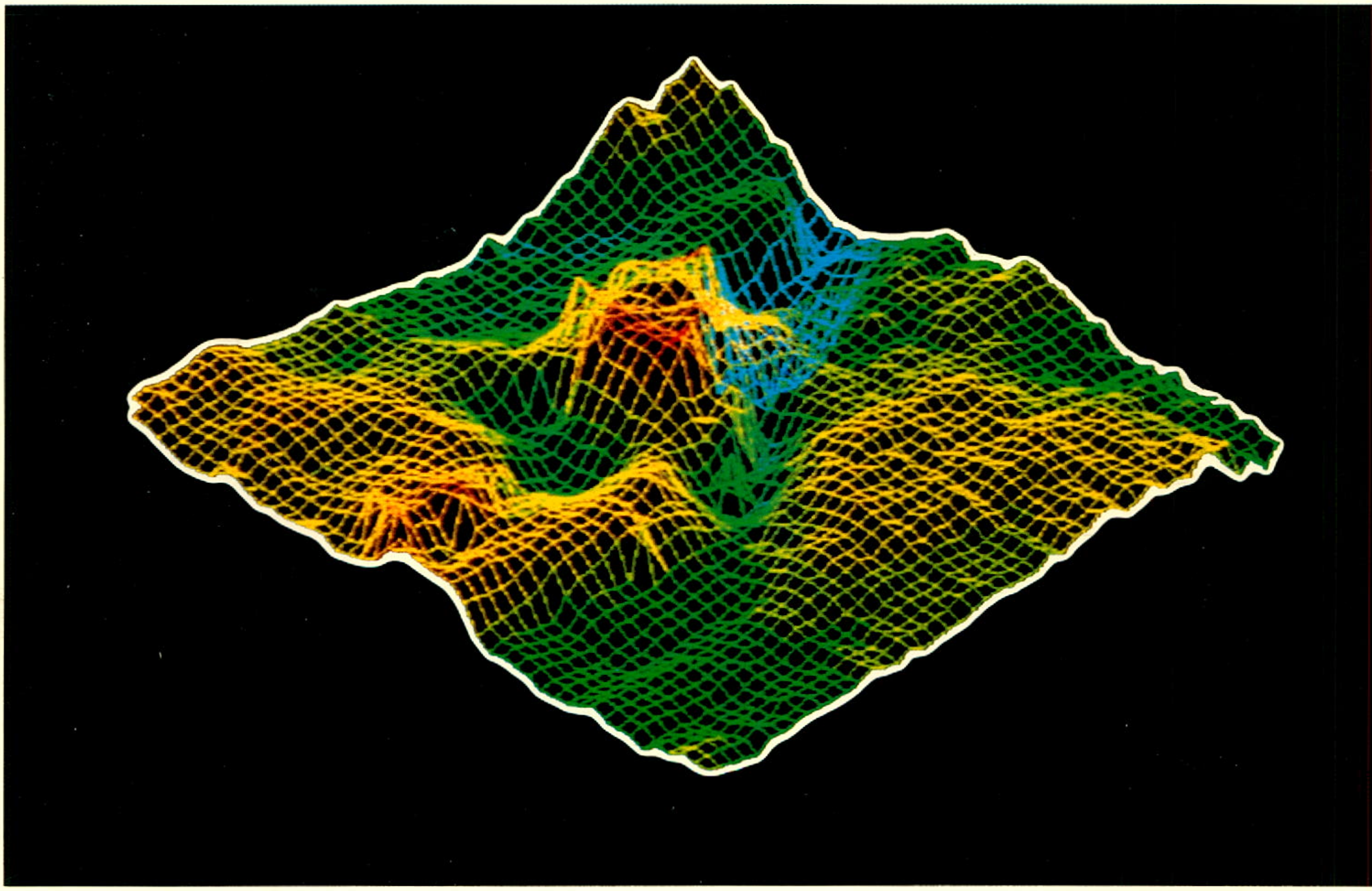
Numac Oil & Gas Ltd.
1985 Annual Report



CORPORATE PROFILE

Numac Oil & Gas Ltd. is a diversified Canadian natural resource company. The principal business of the Company is oil and gas exploration, development and production in western Canada. In addition, Numac has significant interests in a uranium deposit, heavy oil, exploration acreage in the Mackenzie Delta and is also involved in oilfield construction.

The Company is headquartered in Edmonton, Alberta and is listed on the Toronto and American stock exchanges.

ANNUAL GENERAL MEETING

The Annual General Meeting of Shareholders will be held in the Turner Valley Room of the Westin Hotel, 10135 - 100 Street, Edmonton, Alberta, Canada at 9:00 a.m. on Thursday the 5th day of June, 1986.

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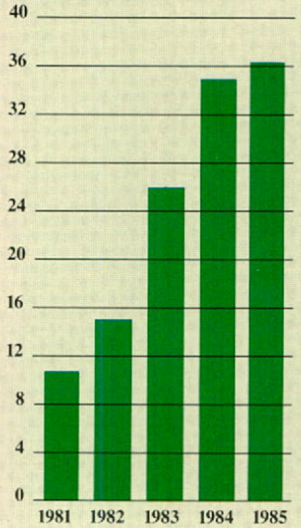
HIGHLIGHTS

Financial	**1985**	1984
Gross Revenue	**$ 73,680,030**	$ 69,567,448
Cash Flow from Continuing Operations	**36,724,593**	34,755,610
Earnings from Continuing Operations	**17,598,633**	14,703,609
Per Share	**0.77**	0.65
Weighted Average Shares Outstanding	**22,731,656**	22,725,929
Long-Term Debt	**44,750,209**	50,738,628
Shareholders' Equity	**138,727,941**	128,768,481
Net Capital Expenditures	**37,987,324**	41,637,267
Reserves — proven and probable		
Oil and Natural Gas Liquids barrels	**19,863,719**	18,649,089
Natural Gas thousands of cubic feet	**229,186,125**	218,731,445
Production		
Oil and Natural Gas Liquids barrels per day	**4,320**	4,085
Gas Production thousands of cubic feet per day	**8,334**	8,776
Land Holdings — oil and gas		
Gross Acres	**2,390,860**	2,296,032
Net Acres	**539,048**	551,194

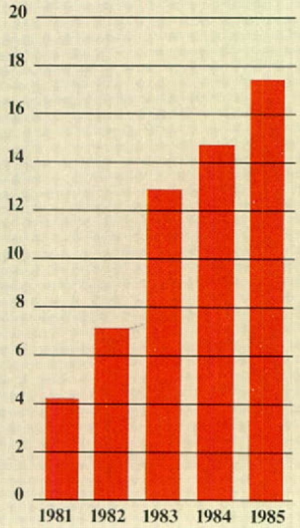
For comparative purposes 1984 results have been adjusted to reflect the sale, in late 1985, of the Company's United States operating subsidiary, Numac Oil and Gas Inc.

All amounts in this report are in Canadian dollars, unless otherwise stated. All production and reserve statistics are on a pre-royalty basis, unless otherwise stated.

Cash Flow
From Continuing Operations
Millions of Dollars



Earnings
From Continuing Operations
Millions of Dollars

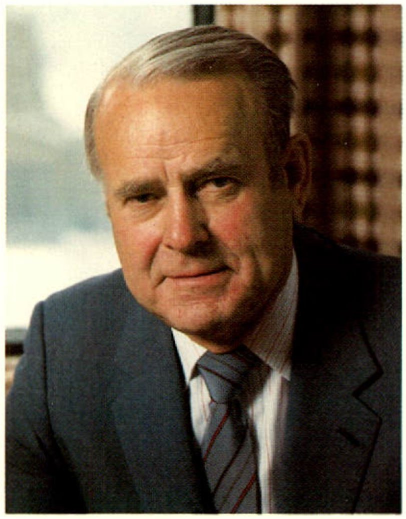


The Cover

This year's cover is a computer graphic created from a three-dimensional seismic program conducted over a portion of the Company's Tangent oil field. Three-dimensional seismic is a relatively new development which assists explorationists in interpreting geologically complex areas.

TO OUR SHAREHOLDERS

On behalf of the Board of Directors, I am pleased to report continued improvement in the operating results of your Company for the year ended December 31, 1985. Notwithstanding a difficult operating environment, 1985 was a year of notable achievements.



As compared to 1984, gross revenue increased by 6% to $73.7 million and cash flow increased by 6% to $36.7 million, or, $1.62 per share. Earnings from continuing operations increased by 20% to $17.6 million, or, $0.77 per share. The sale of the Company's wholly-owned subsidiary, Numac Oil & Gas Inc., resulted in an aggregate capital and operating loss of $7.3 million which reduced final profit to $10.3 million, or, $0.45 per share. Net proceeds from the sale in the amount of $7.8 million were applied to reduce corporate debt. The impact of the sale on future operating cash flow and earnings will be negligible since the loss in production revenues will be offset by lower interest expense resulting from the reduction in debt.

During 1985 we improved upon our already strong financial position. Long-term debt at year end, in the amount of $44.8 million, represented 32% of shareholders' equity. Further, our debt servicing ratio was a strong 6.3 to 1. Our financial strength has been an important factor behind our ability to expand our exploration and development programs.

Significantly, improved operating results were achieved notwithstanding capacity constraints in the major Canadian crude oil pipeline system which necessitated the prorationing of Alberta crude oil production throughout the year. Canadian crude oil and natural gas liquids production averaged 4,320 barrels per day (bpd) as compared to 4,085 bpd during 1984, an increase of 6%. Prorationing was less severe in the fourth quarter with the result that production averaged 4,815 bpd. Estimated crude oil productive capacity at year end was approximately 5,200 bpd. Although we will continue to experience prorationing during the forthcoming year, the impact on production volumes is not expected to be as severe as that experienced in 1985. Furthermore, additions to pipeline capacity are targeted to be completed in late 1986 with the resultant elimination of prorationing.

For the sixth consecutive year, your Company achieved its objective of increasing its net crude oil and natural gas liquids reserves. Numac's 1985 exploration and development program resulted in the discovery of 3.2 million barrels of crude oil and natural gas liquids, thereby replacing production by 212%. After deducting production of 1.5 million barrels and adjustments to prior years' reserves, Canadian crude oil and natural gas liquids reserves increased to 19.9 million barrels. These additions have extended your Company's crude oil reserve life index to 13 years. Canadian gas production averaged 8.3 million cubic feet per day as compared to 8.8 million cubic feet per day during 1984, a reflection of soft gas markets throughout the year. An improvement in natural gas sales is expected in 1986 and subsequent years as a result of the recent deregulation of gas prices and markets. The Company's natural gas reserves of 229 billion cubic feet could sustain substantially higher sales volumes than those experienced to date.

Notwithstanding the recent volatility of world oil prices, the prospects for continued growth have been enhanced by major changes to Canadian energy policy during the past year. The combined effect of these changes, which are more fully discussed on the following page, is not only to increase the value of existing oil and gas assets but to enhance the economics of oil and gas exploration in Alberta. These policy changes serve to protect the Canadian producer during the current period of depressed world oil prices and, when prices improve, will provide an enhanced environment for sustained future growth. Notwithstanding a significantly improved fiscal environment, we will be closely monitoring our capital expenditures program with a view to operating substantially within available cash flow. . . recognizing at the same time that adversity often creates opportunities not otherwise available.

In our view, those companies best positioned to prosper in the current fiscal environment are those with a demonstrated ability to economically add to their crude oil reserves and production. We are confident that Numac is such a company and, notwithstanding the challenges currently faced by our industry, we look forward with enthusiasm to providing sustained future growth for our shareholders.

The high level of performance of Numac's employees continues to be one of the major strengths of your Company. On behalf of the Board of Directors, I would like to record our appreciation for their dedicated effort and loyal support which contributed to a successful 1985. Furthermore, we wish to express our appreciation to our shareholders for their continuing support.

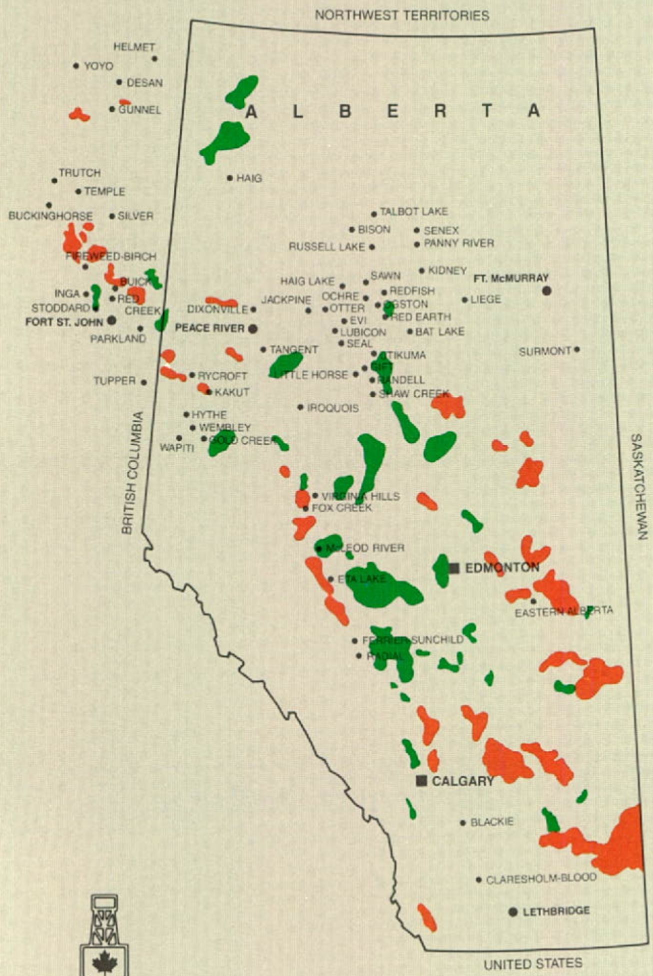
Sincerely,

W. S. McGregor

W. S. McGregor
President and Chief Executive Officer

Edmonton, Alberta
March 3, 1986

OVERVIEW



NUMAC OIL & GAS LTD.

Western Canadian Properties

- Area of Interest
- Oil Field
- Gas Field

Numac is, first and foremost, an oil and gas exploration company and, within that description, is principally an oil exploration company. Our operating strategy for the last several years has been, and will remain, devoted principally to the exploration for and development of crude oil reserves and production. The adoption of this strategy was initiated as a result of the implementation of world prices for crude oil production discovered subsequent to January 1, 1981. Prior thereto the Company had also emphasized gas exploration and as a result now has a large inventory of shut-in gas reserves which, as markets improve, will have a significant impact on future cash flow and earnings.

The success of our oil exploration strategy is evidenced by the fact that Numac has consistently increased its crude oil reserves, from 11.6 million barrels in 1980 to 19.9 million barrels in 1985. This represents an increase of 72%, or, an average annual compound growth rate of 11%. During this five year period Numac discovered 13.4 million barrels of crude oil, or, 263% more than the Company produced.

Crude oil and natural gas liquids production has increased from 1,493 bpd in 1981 to 4,320 bpd in 1985, an increase of 189%, or, an average annual compound growth rate of 30%. Production capacity at year end approximated 5,200 bpd.

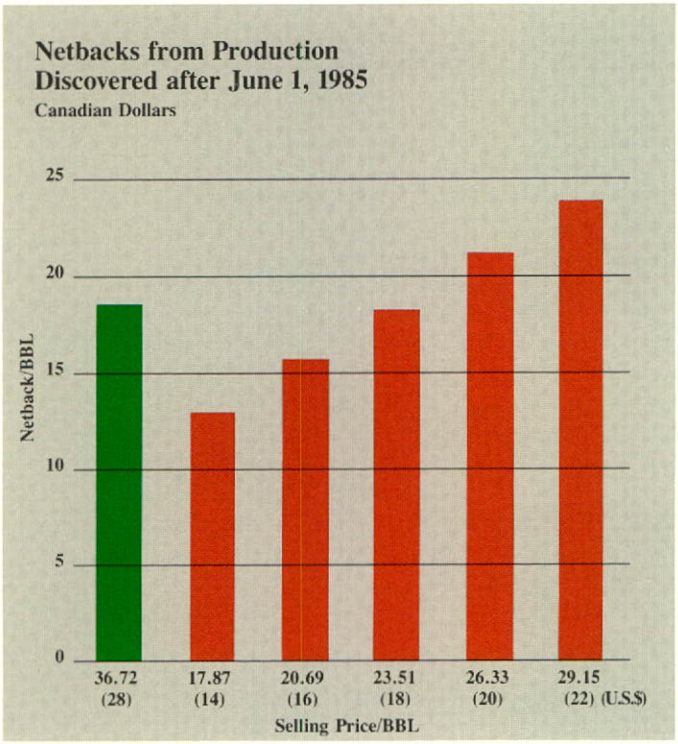
Our achievements are further reflected by the fact that since 1981 revenue, cash flow and earnings from continuing operations have grown at average annual compound rates of 32%, 35%, and 43%, respectively. It is significant that improvements in Numac's reserves, production and financial performance were achieved in a very difficult fiscal environment following the introduction of the National Energy Program (NEP) in the fall of 1980.

Success in any industry is largely dependent upon the ability to adjust to rapidly changing fiscal and economic conditions. Our successes following the NEP reflect our ability to adapt to the challenges of sudden and dramatic changes to the fiscal environment within which we operate. By application of sound financial planning and responding to opportunities presented, your Company achieved significant growth in the years following NEP.

An important message we would like to convey is that the major positive changes to Canadian energy policy introduced during 1985 will provide a significant cushion against the effects of the recent downturn in world oil prices. These changes include: (1) the phased elimination of the Petroleum and Gas Revenue Tax (PGRT) on production from wells drilled prior to April 1, 1985 and the elimination of PGRT on production from wells drilled thereafter; (2) expanded royalty holidays for wells drilled after June 1, 1985; (3) a 5% reduction in marginal royalty rates over the next two years; and, (4) a 50% increase in the Alberta Royalty Tax Credit to a maximum of $3 million per year commencing April 1, 1986. These changes to energy policy not only shelter cash flow from existing production against the effect of lower prices but, more importantly, significantly enhance the economics of future exploration.

Numac's average selling price during 1985 for crude oil production discovered prior to April 1, 1985 (for the purposes hereof "old oil") was $36.72 ($28.00 U.S.) per barrel. After deducting royalties, PGRT and lifting costs Numac's pre-tax cash flow netback ("netback") from this production was $18.85 per barrel. By comparison, wells drilled after June 1, 1985 (for the purposes hereof "new oil") are free of PGRT and receive royalty holidays which are intended to approximate 35% of the cost of drilling and equipping an average well.

As illustrated on the graph below, new oil production receives a netback of $18.51 based on a selling price of $23.51 ($18.00 U.S.) per barrel. Accordingly, netbacks from new oil production are equivalent to those received from old oil production notwithstanding a 36% reduction in selling price, or, $13.50 ($10.00 U.S.) per barrel.



Numac's average pre-tax cash flow netback per barrel during 1985 from production discovered prior to April 1, 1985.

Numac's estimated pre-tax cash flow netback per barrel from production discovered subsequent to June 1, 1985 which is exempt from PGRT and receives royalty holidays.

**The Canadian selling prices on the above graph are net of transportation costs and are based on a conversion factor of $1.00 U.S. = $1.41 Cdn.*

Accordingly, the challenge facing our industry is not that the economics of future oil exploration are unattractive but rather the efficient utilization of reduced cash flow in the event of a prolonged continuation of currently depressed selling prices. Funds available for future exploration are further impacted by the elimination of Petroleum Incentive Program payments effective March 31, 1986; however, this loss will, in our view, be partially or totally offset by reduced exploration costs.

Although world oil prices are unpredictable in the short-term, it is our view that the currently depressed prices will not be sustainable in the longer term. In this uncertain environment it is management's intention to adjust capital expenditures to reflect current pricing realities. Our continuing policy will be to operate within available cash flow so as to maintain a strong balance sheet and debt servicing ratio. In the pursuit of this objective Numac will continue to concentrate upon the cost effective deployment of available cash flow. Further, having regard to our relatively strong financial position, your Company is well positioned to respond to those opportunities which undoubtedly will be created should the current economic environment continue.

"Our new challenge will be to successfully adapt to a changing economic environment brought about by the recent volatility of world oil prices.

We feel Numac is well positioned to respond to this challenge."

EXPLORATION

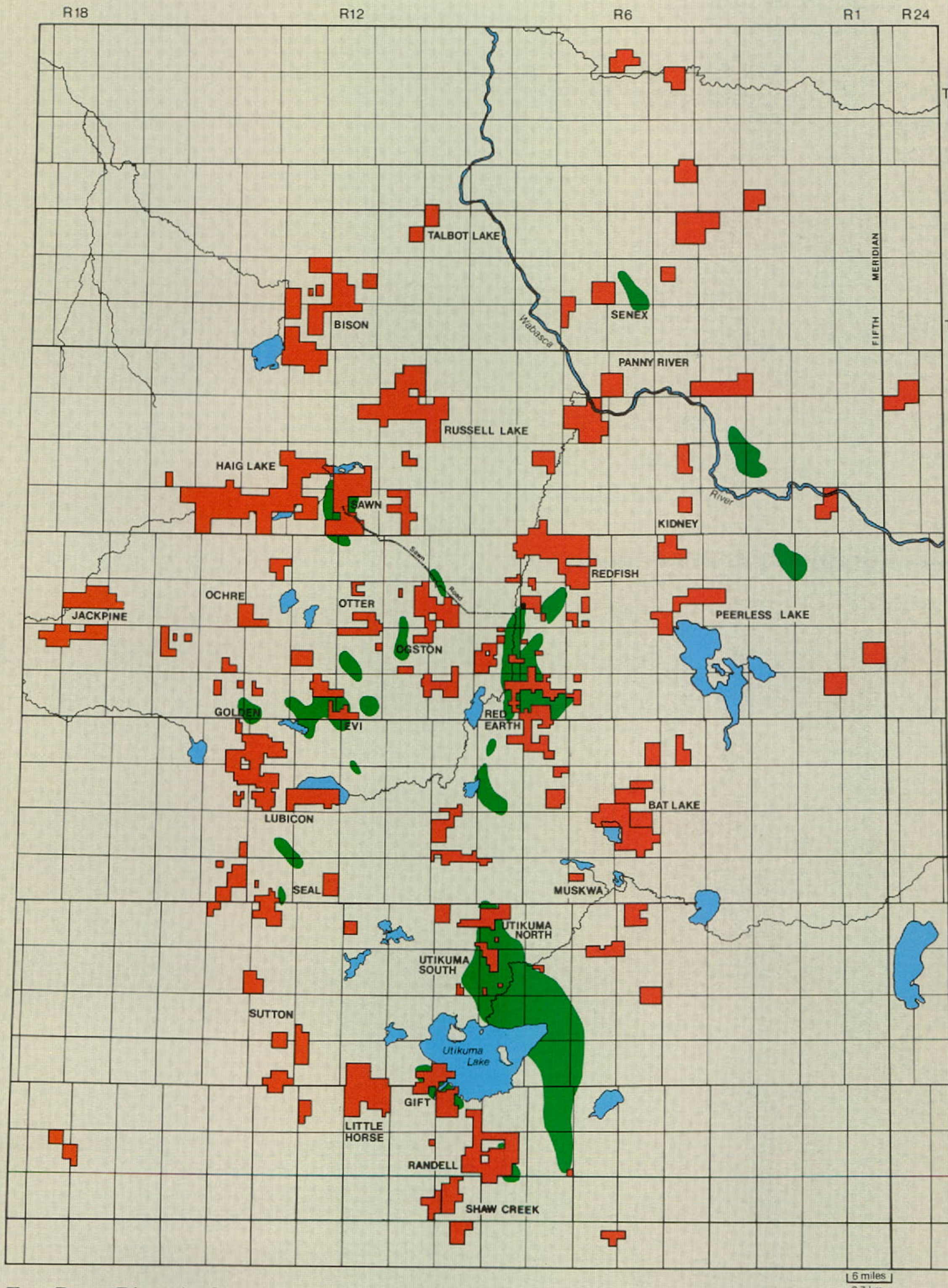
Numac's 1985 exploration and development program was the most active in the Company's history. The impetus for this program was provided not only by the availability of excellent prospects but also by a desire to maximize Petroleum Incentive Program payments prior to their expiry on March 31, 1986. Further, the economics of oil exploration in the Province of Alberta were significantly enhanced by the changes to energy policy referred to earlier which have substantially improved cash flow netbacks on new production. The Company's aggressive program is reflected by the fact that capital expenditures in Canada for land, seismic and drilling were $42.2 million before provision for PIP payments, an increase of 38% as compared to 1984.

During 1985, Numac participated in the drilling of 136 wells in Canada, 59 of which were cased for oil, 19 cased for gas and 58 were abandoned for a success ratio of 58%. This drilling program resulted in the discovery of significant new oil reserves and additions to production, the particulars of which are referred to later in this report.

The map opposite highlights an area of north-central Alberta in which Numac has, for many years, concentrated its exploration activities. This oil prospective area is commonly referred to as the East Peace River Arch. As a result of recent Keg River oil discoveries, the prospective oil exploration area has been significantly extended to the northeast into what is referred to as the Senex-Peerless Lake area.

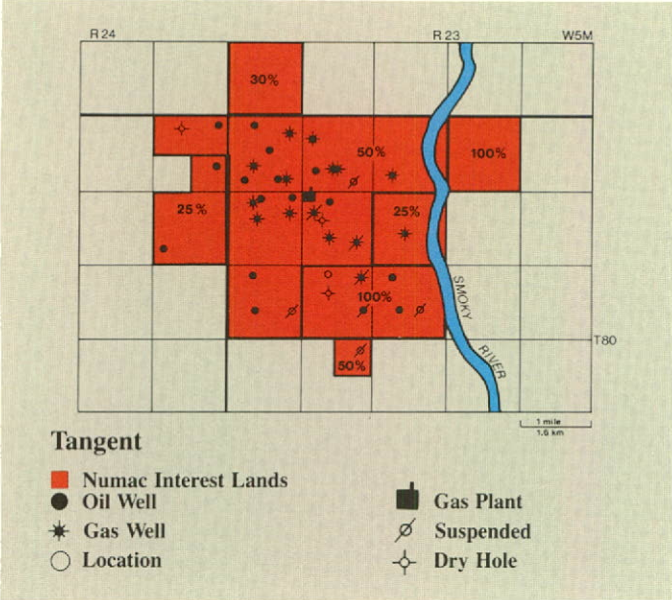
The Company's land holdings in the mapped area consist of an average working interest of 33.3% in approximately 643,000 gross acres and constitutes one of the best land positions of any major or independent company. Oil production is from the Granite Wash, Gilwood, Keg River and Slave Point formations. The Company's principal producing fields in the mapped area are Utikuma, Red Earth, Gift, Sawn and Evi. We are convinced that the area will remain a focal point of exploration and development activity for many years based upon the vast area of unexplored sediments and the number of potential pay horizons.

As a result of our exploration effort during the 1984-85 winter drilling season we are now evaluating several new oil discoveries which are expected to make significant contributions to 1986 production. These include Panny River in the Senex-Peerless Lake area and Shaw Creek, Seal and Bat Lake in the East Peace River Arch area. Other areas of current exploration and development activity, some of which are outside of the mapped area, include Tangent, Red Earth, Utikuma, Redfish, Russell Lake, Randell, Sawn, Gold Creek and Virginia Hills. Several prospects which are currently the subject of active exploration and development programs are discussed on the following pages.



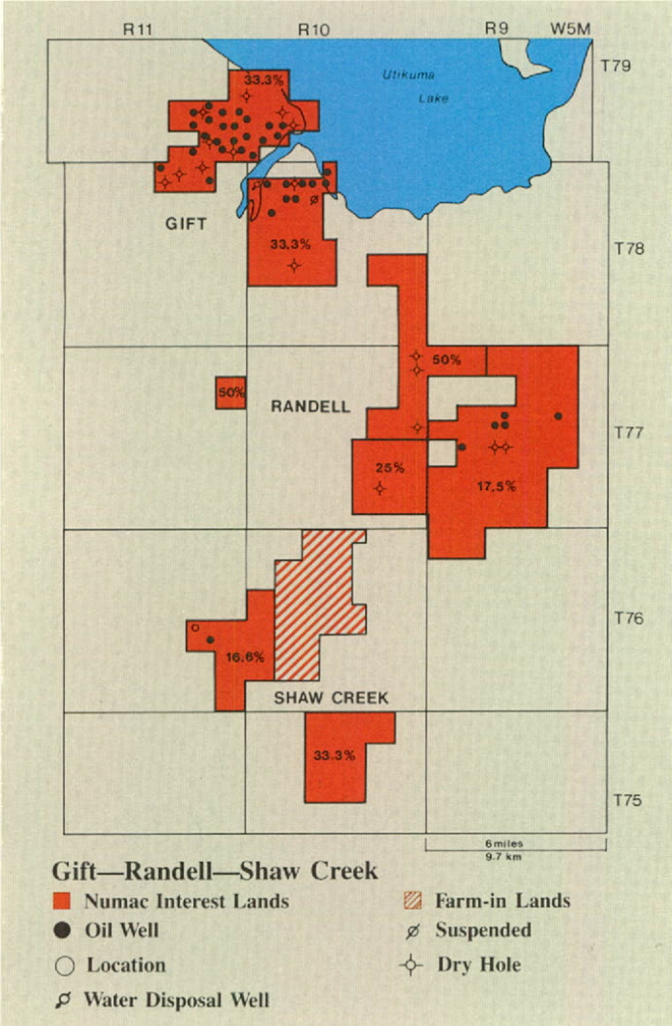
East Peace River Arch

- Numac Interest Lands
- Oil Fields



Tangent

During 1985, Numac, as operator, participated in the drilling of eight wells at Tangent to test the Wabamun formation. As a result of this program, four wells were completed for production. Allowables for these wells range from 50 to 664 bpd and increased Numac's productive capacity in the field by 60% from 875 to 1,400 bpd. Tangent is now Numac's most productive oil field and will be the subject of continued exploration and development activity in an effort to further delineate the high productivity dolomite reservoirs. A three-dimensional seismic program has recently been completed on a portion of the Tangent acreage, the preliminary assessment of which is very encouraging. As a result of our successes at Tangent we will be pursuing other Wabamun prospects in the general area.



Gift

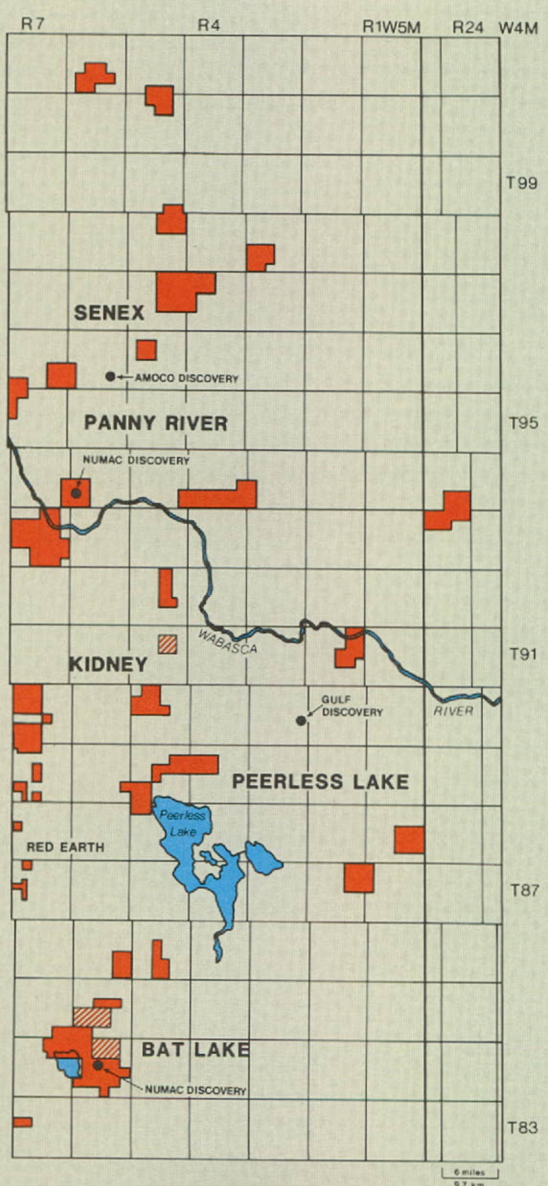
Since the discovery of the Gift field in 1983, a total of 29 wells have been completed for production in one or more of the Granite Wash, Gilwood or Slave Point formations. Geological and engineering studies are currently being conducted with respect to the implementation of a waterflood enhanced recovery scheme in the Slave Point formation. The objective of this program is to substantially increase production and recoverable reserves from the field.

Randell

At Randell, to the southeast of Gift, Numac has working interests ranging from 17.5% to 50% in 26,720 acres. During 1985, Numac participated in three successful exploratory wells on its 17.5% interest acreage. Additional drilling will be conducted on these lands during 1986 which are prospective for Slave Point and Gilwood production.

Shaw Creek

In early 1985, Numac participated in an oil discovery at Shaw Creek, the particulars of which must remain confidential for competitive reasons. The discovery well was drilled pursuant to a farm-in and, as a result, Numac earned a 16.6% interest in 4,480 acres. Subsequently, the Company acquired a 33.33% interest in a 3,840 acre licence and a 100% interest in a 640 acre lease southeast of the discovery. Numac will continue to examine land acquisition opportunities as the exploration program in this area progresses.



Senex-Peerless Lake

Numac Interest Lands
Farm-in Lands

Rycroft

So as to facilitate a secondary recovery project, Numac converted its 28% working interest in seven of its nine Charlie Lake oil wells at Rycroft into a 7.9% interest in the Rycroft unit. The enhanced oil recovery project, using water injection, was initiated during the last quarter of 1985 and is expected to double the recoverable reserves in the field. Increased production is expected to commence in the second quarter and will be free of PGRT. In addition, four wells have been cased for gas on this acreage which will be completed for production as markets develop.

Seal

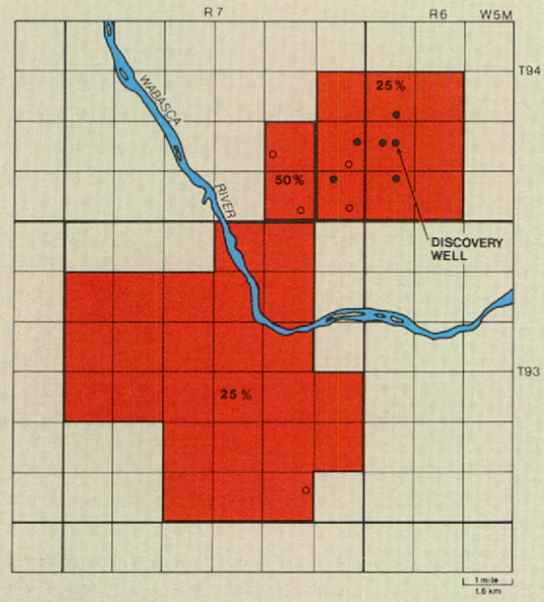
At Seal, approximately five miles southwest of the highly productive Slave field, Numac participated in an oil discovery on a 3,840 acre lease in which the Company has a 16.6% working interest. In addition to the discovery lands, Numac has interests ranging from 16.6% to 50% in an additional 17,280 acres in this play. Subsequent to the discovery, three additional wells have been drilled of which two were cased for oil production. Several additional locations will be drilled during 1986.

Senex-Peerless Lake

The Senex-Peerless Lake area of north-central Alberta has, during the past two years, become a focal point of industry activity due to significant discoveries made by Amoco in the Senex area and by Gulf in the Peerless Lake area. The primary objectives are oil bearing reefs in the Devonian Keg River formation. The key exploration tool in the delineation of these reefs is closely controlled high-resolution seismic which has been initiated on most of the acreage in which Numac has an interest.

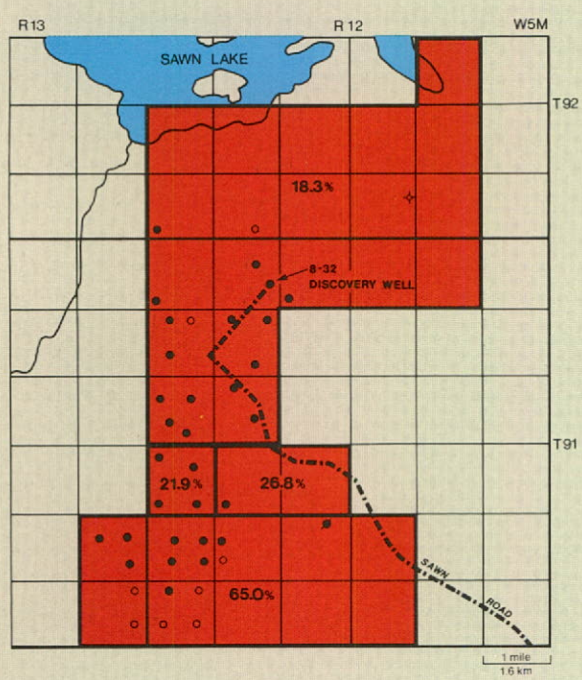
At year end, Numac had an average working interest of 33% in 141,670 acres of trend acreage in this play and will continue to selectively increase its land position.

In early 1985, Numac participated in an oil discovery on its Panny River acreage in the Senex-Peerless Lake area, particulars of which are discussed below. In addition to the delineation program in the vicinity of the discovery well, Numac has or will be participating in a minimum of seven exploratory wells on its Senex-Peerless Lake acreage in early 1986. These include three exploratory wells on an 11,520 acre block of land located approximately 10 miles due east of the Panny River discovery in which Numac has a 25% working interest and a minimum of three exploratory wells on what is referred to as its Kidney acreage to the southeast of Panny River. In addition, an exploratory well will be drilled approximately seven miles southwest of the Panny River discovery on a block of land in which the Company has a 25% working interest. Numac is very encouraged by the initial results of this exploratory drilling program.



Panny River

- Numac Interest Lands
- Oil Well
- Location



Sawn

- Numac Interest Lands
- Oil Well
- Location
- Suspended
- Dry Hole

Panny River

An exploratory well drilled at Panny River in the Senex-Peerless Lake play during the first quarter of 1985, PCP et al Senex 10-7-94-6 W5M, flowed oil at rates up to 317 bpd from the Keg River formation. The well was drilled on a 5,760 acre lease block in which Numac has a 25% working interest and is highlighted on the accompanying map. Since the initial discovery Numac has participated in five additional wells on this acreage, all of which have been cased for oil production. Particulars of these wells, which are expected to make a significant contribution to Numac's reserves and production, must remain confidential for competitive reasons. A three-dimensional seismic program is expected to be conducted on these lands and a multi-well exploratory and delineation program is planned during the balance of 1986.

Numac also has interests from 25% to 50% in 17,280 acres contiguous to the discovery block and, as previously mentioned, an exploratory well will be drilled on the 25% interest acreage prior to spring break-up.

Red Earth

During 1985, Numac participated in 21 wells on its Red Earth acreage, 14 of which were completed for oil production in the Granite Wash formation and one in the Slave Point formation. Several additional locations will be drilled during 1986 to further delineate the Red Earth field and to explore other prospects in this highly oil prone area.

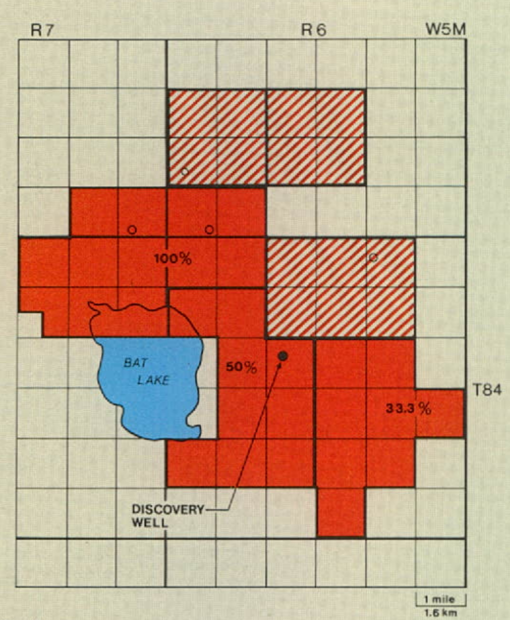
Utikuma

Four wells were drilled during 1985 on the Company's Utikuma acreage, two of which were completed for Granite Wash oil production. We anticipate additional drilling to further delineate this field in the forthcoming year.

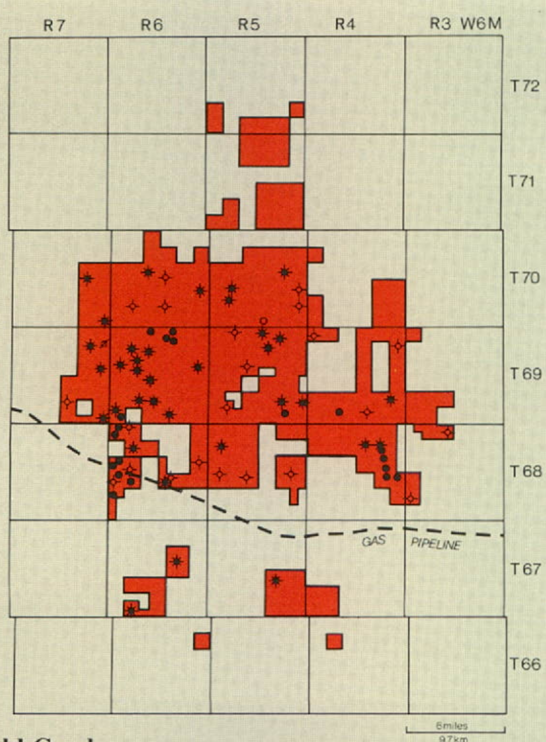
Sawn

At Sawn, Numac has an average working interest of 33.2% in 21,120 acres. The discovery well, drilled in 1983, is productive in the Slave Point formation and is royalty free for five years. Including the discovery, there are now 11 producing Slave Point oil wells on the 12,800 acre discovery block in which Numac has an 18.3% working interest.

In addition, Numac, as operator, has to date cased nine wells for Slave Point oil production on a 6,400 acre block located approximately 3.5 miles south of the discovery well. Several additional locations will be drilled to further delineate the Slave Point reservoir on these lands in which the Company has a 65% working interest. Further, Numac has recently completed a fourth Slave Point oil well on a 640 acre lease in which it holds a 21.9% interest. Reservoir studies are currently underway with respect to the feasibility of a secondary recovery project, the objective of which is to increase production and recoverable reserves.



Bat Lake
Numac Interest Lands
Farm-in Lands
Oil Well
Location



Gold Creek
Numac Interest Lands
Suspended
Dry Hole
Oil Well
Gas Well
Location

Bat Lake

In early 1985, Numac participated in a Devonian oil discovery at Bat Lake which is approximately 20 miles southeast of Red Earth. The well, particulars of which are confidential for competitive reasons, is located on a 5,760 acre block of land in which Numac has a 50% working interest. Subsequent to the discovery, Numac acquired an 85% working interest in 7,520 acres at Crown lease sales. The Company now has an average working interest of 59.7% in 18,400 contiguous acres in this play and the right to earn interests in 8,960 additional acres pursuant to farm-in agreements. Further, Numac has interests in other exploratory acreage in the vicinity of this play. Extensive seismic has been completed on the Bat Lake lands and a multi-well exploratory drilling program is planned for early 1986.

McLeod River

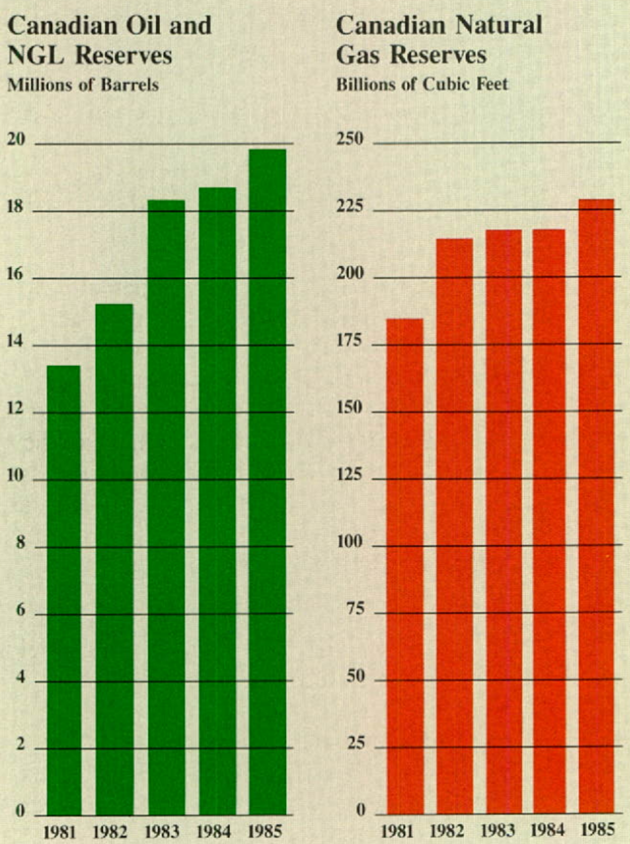
At McLeod River, approximately five miles northeast of Hinton, Alberta, the Company is currently participating as to a 15% working interest in a 16,000 foot gas prospect, Cdn-Sup et al Hinton N 7-18-52-24 W5M. Although there are several prospective gas zones, the primary objective is to test the highly productive gas reserves in the Leduc formation. In addition, the economics of the well are enhanced by the prospect for significant recoveries of sulphur.

Gold Creek

At Gold Creek, in the oil and gas productive Elmworth trend, Numac has interests from 7.5% to 25% in 180,480 acres. The Company now has interests in 25 gas wells which have been cased for production from one or more formations. The most significant discovery on this acreage is the 10-34-69-5 W6M well which production tested at the rate of 24.2 mmcf of gas and 1,200 barrels of condensate per day from two zones in the Wabamun formation having a combined pay thickness of 161 feet. A substantial portion of the Gold Creek acreage has been dedicated to a gas purchase contract with ProGas Limited. The prospects of production from this area have been significantly enhanced as a result of a much improved outlook for Canadian gas exports.

The Company also has an interest in two oil fields on its Gold Creek acreage which are productive from Triassic zones. In addition, Numac participated in a new oil discovery on its Gold Creek acreage during 1985 which is expected to develop into a third Triassic oil field. The Company also participated in an oil discovery in the Doe Creek formation and has since drilled three successful offsets to this well. The Triassic and Doe Creek oil potential of the Gold Creek lands will be further delineated during 1986.

RESERVES



*Oil and gas reserves are before royalty.

Numac's petroleum and natural gas reserves are calculated annually by McDaniel & Associates Consultants Ltd., independent petroleum engineers.

The Company's successful exploration and development drilling program conducted during the past year resulted in the discovery of 3.2 million barrels of crude oil, or, approximately 212% more than was produced during the year. After deducting 1985 production of 1.5 million barrels and revisions to prior years' reserves, the Company's year end reserves increased to 19.9 million barrels.

1985 was the sixth consecutive year that Numac has increased its crude oil and natural gas liquids reserves. Based on 1985 production rates, the Company's reserve life index for crude oil and natural gas liquids increased to 13 years. Additions to reserves were primarily in the Company's Tangent, Red Earth, Utikuma, Sawn and Virginia Hills fields. Further, several new pools were discovered during the year which are currently being delineated by development drilling. Preliminary indications are that substantial new reserves will be added in the coming year.

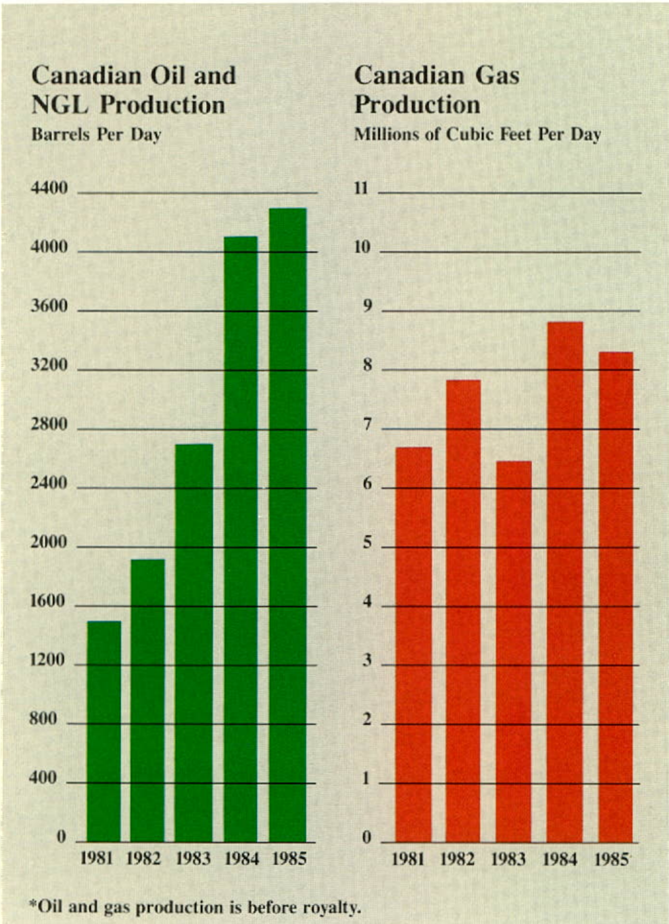
During 1985, Numac again maintained its policy of not actively exploring for or developing gas reserves except where necessary to hold land or to satisfy deliverability contracts. Consequently, the Company's gas reserves, after production of 3 billion cubic feet (bcf), increased to 229 bcf as compared to 219 bcf at December 31, 1984. At such time as development programs are justified by improved gas markets, the Company's gas reserves could be significantly expanded upon by development drilling.

Reserves	**OIL AND NGL (thousands of barrels)**			**NATURAL GAS (billions of cubic feet)**		
	Proved	**Probable**	**Total**	**Proved**	**Probable**	**Total**
Reserves at December 31, 1984	11,969	6,680	18,649	151.29	67.44	218.73
New reserves added	2,319	897	3,216	7.25	0.87	8.12
Revisions	(301)	(190)	(491)	7.11	(1.74)	5.37
Reserves produced	(1,510)		(1,510)	(3.04)		(3.04)
Reserves at December 31, 1985	12,477	7,387	19,864	162.61	66.57	229.18

Proved reserves are considered to be those reserves which to a high degree of certainty are recoverable at commercial rates under present depletion methods and current operating conditions, prices and costs.

Probable reserves are considered to be those reserves commercially recoverable as a result of the beneficial effects which may be derived from the future institution of some form of enhanced recovery scheme or as a result of the more favourable performance of the existing recovery mechanisms than that which could be deemed to be proven at this time.

PRODUCTION



Canadian crude oil and natural gas liquids production averaged 4,320 bpd during 1985 as compared to 4,085 bpd during 1984, a relatively modest increase of 6%. Significantly, crude oil production increased by 9% despite prorationing throughout the year primarily due to lack of capacity in the major crude oil pipeline system. Further, natural gas liquids extracted from the gas processed through the Empress gas liquids plant declined from 271 to 182 bpd as a result of weakness in gas export markets.

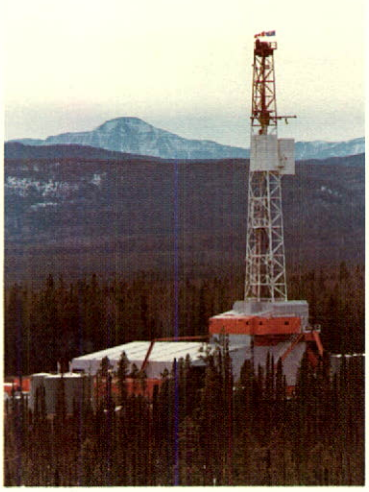
Prorationing was less severe in the fourth quarter with the result that Canadian crude oil and natural gas liquids production averaged 4,815 bpd. Estimated productive capacity at year end, excluding natural gas liquids, was approximately 5,200 bpd. Although we will continue to experience prorationing during the forthcoming year, the impact upon production volumes is not expected to be as severe as that experienced in 1985. Furthermore, additions to pipeline capacity are targeted to be completed in late 1986 with the resultant elimination of prorationing.

The most significant production increases were achieved in the Company's Tangent, Gift, Red Earth and Sawn fields. New producing areas which did not make a significant contribution to 1985 production but which hold the potential for future production increases include Panny River, Virginia Hills, Bat Lake, Randell and Shaw Creek. Numac's continuing strategy will be to increase crude oil production, particularly since essentially all new production qualifies for royalty relief and is exempt from PGRT.

Canadian gas production averaged 8.3 million cubic feet per day as compared to 8.8 million cubic feet per day during 1984, a reflection of soft gas markets throughout the year. An improvement in natural gas sales is expected in 1986 and subsequent years as a result of the recent deregulation of gas prices and markets. The Company's natural gas reserves could sustain substantially higher sales volumes than those experienced to date. Numac's gas sales are primarily pursuant to contracts with ProGas, TransCanada Pipelines and Pan-Alberta Gas.

LAND

Numac maintained an active land acquisition program during 1985, the primary objective of which was to enhance the Company's oil prospective land base. Purchases were restricted to the Province of Alberta where, excluding land brokerage companies, Numac was within the top 20 most successful bidders. Expenditures of $8.2 million resulted in the acquisition of 188,320 gross (79,162 net) acres. In addition, 39,396 gross (12,315 net) acres were earned pursuant to farm-in agreements. After adjusting for expiring lands and conversion of licences to leases, the Company's gross working interest acreage decreased by 22,328 acres while its net working interest acreage increased by 51,474 acres.



Total land bonuses paid by industry to the government of the Province of Alberta were the highest since 1980, reflecting the continued recovery of the conventional oil and gas industry in Alberta. Average prices paid per acre have not recovered to the same extent which we believe reflects a trend towards the acquisition of exploratory acreage. Numac's average land acquisition costs during 1985 were $103.00 per acre as compared to the industry average of $116.00 per acre.

Most of the additions to Numac's land base were in the oil prospective East Peace River Arch and Senex-Peerless Lake areas of north-central Alberta. The most significant additions to the Company's acreage position in the East Peace River Arch area were at Red Earth, Bat Lake, Seal, Russell and Sutton Lake. Further, the Company continued to expand upon its trend acreage in the Senex-Peerless Lake area where it now has interests in 145,510 gross (47,095 net) acres. The principal acquisitions in this area were at Panny River and Kidney.

Other mineral rights held by the Company, consisting of base and precious minerals claims, leases and permits, totalled 17,055 gross (3,412 net) acres. These include mineral leases associated with the Midwest Lake uranium deposit, uranium prospective leases in the Carswell Dome area of northern Saskatchewan, gold prospective leases in the Northwest Territories and lead-zinc prospective claims in the Selwyn area of the Yukon Territory.

Land Holdings

Petroleum and natural gas rights as at December 31, 1985 were:

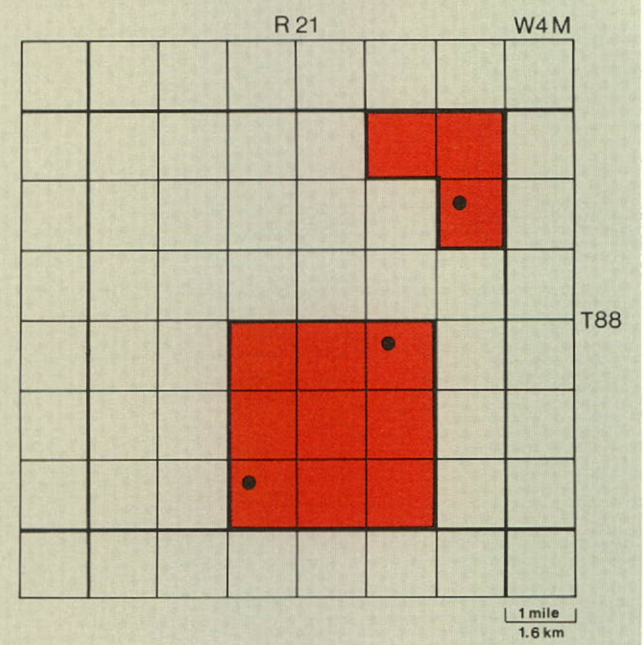
	DEVELOPED		UNDEVELOPED		TOTAL ACREAGE	
	Gross	Net	Gross	Net	Gross	Net
Working Interest Acreage						
Alberta	183,989	50,013	1,288,757	370,216	1,472,746	420,229
British Columbia	35,452	13,294	324,449	105,525	359,901	118,819
	219,441	63,307	1,613,206	475,741	1,832,647	539,048
Royalty Interest Acreage						
Alberta	22,427		210,174		232,601	
British Columbia	3,887				3,887	
Mackenzie Delta	1,502		268,740		270,242	
Other	160		51,323		51,483	
	27,976		530,237		558,213	
TOTAL	247,417	63,307	2,143,443	475,741	2,390,860	539,048

"Developed acreage" is the drilling spacing units underlying oil or gas wells which are producing or, following completion and/or installation of production facilities, are capable of production. Drilling spacing units are, generally, 640 acres in the case of a gas well and 160 acres in the case of an oil well. "Undeveloped acreage" is all other acreage in which the Company has an interest.

"Gross acreage" is the total acreage in which the Company has an interest. "Net acreage" is the percentage of gross acreage in which the Company has a working interest.

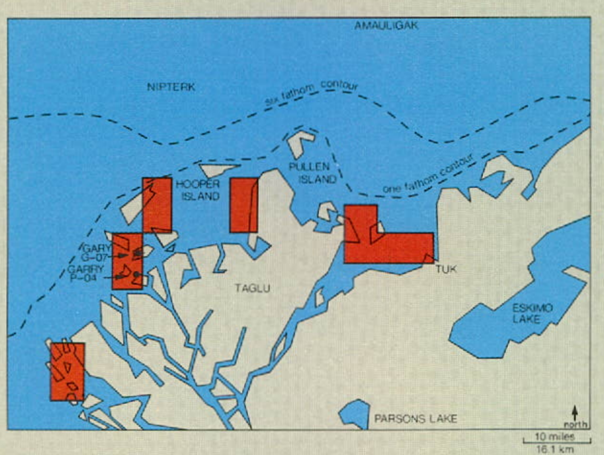
"Working interest acreage" means those lands in which the Company has an operating or participating interest. "Royalty interest acreage" means those lands in which the Company does not have an operating or participating interest but from which the Company receives or is entitled to receive a share of production revenues.

OTHER ACTIVITIES



Liege

■ **Numac Interest Lands** ● **Heavy Oil**



MacKenzie Delta

■ **Numac Interest Lands**
● **Oil and Gas Well**
✱ **Gas Well**

Heavy Oil

Although we have confidence in the ability of Numac to continue to increase conventional oil reserves and production we are, as a matter of strategy, pursuing the development of heavy oil prospects. This energy source will undoubtedly become a dominant source of Canada's future energy supplies.

In early 1985 Numac drilled three carbonate heavy oil evaluation wells on its 100% owned Liege (formerly Buffalo) acreage which comprises 7,680 acres approximately 70 miles west of Fort McMurray. All three of these wells penetrated in excess of 100 feet of heavy oil bearing Grosmont reef at a depth of approximately 1,000 feet. The Company's preliminary engineering evaluation indicates oil in place reserves of approximately 780 million barrels on the 12 section block. Having completed the preliminary evaluation of the reservoir it is Numac's intention to attract an industry partner with the technical expertise to assist with the planned development of this property while at the same time limiting Numac's capital exposure.

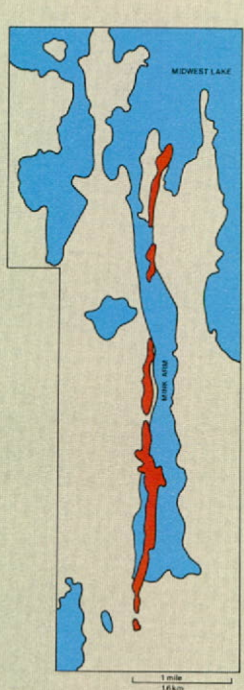
The Company's Surmont property consists of 119,000 acres located approximately 35 miles southeast of Fort McMurray, Alberta. Following substantiation by Numac of the in-situ reserves, the property was farmed out in 1977 to Gulf Canada Resources Inc. Pursuant to the farmout Numac received installment payments exceeding $24 million and retained a 5% net carried interest in the property together with the right to convert the carried interest to a 12.5% participating interest in any or all future oil extraction projects thereon. Independent consulting geologists estimate the bitumen in place at 20 billion barrels.

Having regard to the inherent characteristics of the Liege and Surmont properties, favourable fiscal terms being extended by government to heavy oil recovery projects and ongoing technological developments, Numac's management is enthusiastic regarding the future potential of these properties.

Mackenzie Delta

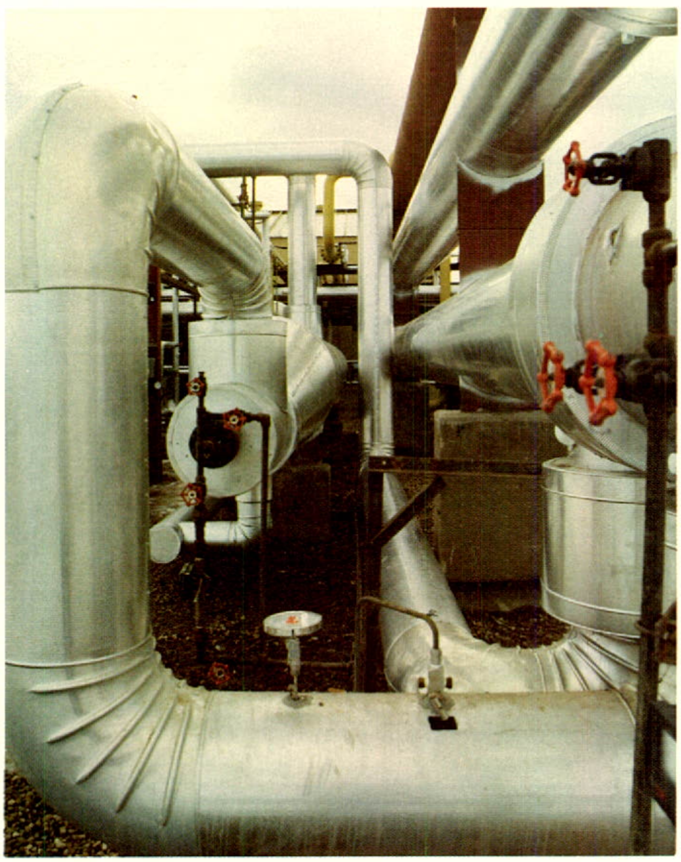
The above map illustrate's Numac's Mackenzie Delta acreage which consists of 270,000 acres in which Numac has a 20% preferred net carried interest. The carried interest is preferred in that the Company is entitled to a share of income from initial sales of oil and gas which escalates to a 20% revenue interest after recovery by others of exploration and development costs. Of the five exploratory wells drilled on these lands to date, the Garry P-04 tested at the rate of 7,920 barrels of oil per day and cumulative gas flows of 31 mmcf per day and the Garry G-07 tested cumulative gas flows of 21 mmcf per day.

As required pursuant to the Exploration Agreement covering the subject lands, a proposal was submitted to the



Midwest Project

■ **Area of Mineralization**



federal government during the first quarter of 1986 with respect to the relinquishment of 50% of the subject lands. The lands to be retained, including three parcels which have been designated as significant discovery areas, are intended to be validated by the drilling of an exploratory well prior to their expiry on March 3, 1988.

The Mackenzie Delta has been a focal point of frontier exploration activity, the development of which has been significantly enhanced by the recent Amauligak and Tuk discoveries. Further, the extension of the Norman Wells oil pipeline to the Mackenzie Delta is under consideration as a viable method of transporting production from the area. Although Numac's Mackenzie Delta interests do not presently contribute to cash flow, management considers this asset to be a source of significant future revenue.

Minerals

Numac is a participant in the Midwest Lake uranium deposit in northern Saskatchewan. The Company has a 25% interest in the property, consisting of a 10% working interest and a 15% carried interest. Based on a report by independent geological engineers, the drill-indicated reserves are calculated at 56 million pounds of uranium oxide having an average grade of 1.25%, or, 25 pounds per ton. Determination of a production commencement date is dependent upon world supply and demand for uranium.

Oilfield Construction

Numac, through its wholly-owned subsidiary McGregor Johanson Contracting Ltd. (MJ), is engaged in oilfield related construction activities. In Alberta these activities include lease preparation, restoration of drilling sites and road building. MJ carries on similar activities, including heavy equipment leasing, in the Mackenzie Delta area of the Northwest Territories. MJ has consistently contributed to the profitability of Numac.

Natural Gas Liquids

Numac has a 5.8% interest in the Empress natural gas liquids plant which was completed in mid-1983 at a total cost of $46 million. This facility extracts natural gas liquids including ethane, propane and butane from the natural gas stream of ProGas Limited and others. Numac's share of natural gas liquids production is dependent upon gas markets and averaged 182 bpd during 1985 as compared to 271 bpd during 1984. ProGas has recently re-negotiated its gas export contracts, which are projected to result in a significant improvement in gas sales and a corresponding increase in natural gas liquids production.

As Numac does not own the liquids until they are extracted from the gas stream, the Company does not report the Empress natural gas liquids as reserves; however, Numac's share of liquids production over the 20-year life of the plant is forecast to exceed four million barrels.

FINANCIAL

Management Discussion

The following discussion of results of operations and financial condition should be read in conjunction with the Consolidated Financial Statements and related notes.

As a result of the sale of the Company's wholly-owned subsidiary, Numac Oil & Gas Inc., on December 30, 1985, the format of the financial statements has been revised to differentiate results of continuing operations from results of discontinued operations.

Revenue

Gross revenue from continuing operations increased by 6% to $73.7 million in 1985 as compared to $69.6 million in 1984. This increase is primarily attributable to increased crude oil production, offset to a degree by lower prices and marginally lower gas sales.

Canadian crude oil and natural gas liquids production averaged 4,320 barrels per day, an increase of 6% as compared to 1984. The most significant increases were realized in the Company's Tangent, Gift, Red Earth and Sawn fields. Increased production was achieved notwithstanding prorationing of Alberta crude oil production throughout 1985. Prorationing was primarily due to a lack of capacity in the major Canadian crude oil pipeline system. As a result of additions to pipeline capacity in late 1985, production cutbacks due to prorationing are not expected to be as severe in 1986.

Effective June 1, 1985 crude oil prices were deregulated, thereby eliminating the two tier pricing system which had been in effect and making crude oil prices more sensitive to the market place. Numac's average selling price for crude oil during 1985 was $36.83 per barrel as compared to $37.68 per barrel in 1984.

Revenue from gas sales decreased to $7.6 million in 1985 from $8.7 million in 1984. This 12% decline is primarily attributable to a decrease in the average selling price to $2.51 per thousand cubic feet as compared to $2.70 per thousand cubic feet in 1984. Further, gas sales volumes decreased by .5 million cubic feet per day to average 8.3 million cubic feet per day as a result of soft gas markets throughout the year. An improvement in gas sales volumes is expected in 1986 due to the recent deregulation of gas prices and markets.

The Alberta Royalty Tax Credit received by Numac remained constant at $2.0 million per year for the years 1984 and 1985. Numac will continue to qualify for the maximum royalty tax credit which, as a result of changes to government policy announced in 1985, will increase to $2.75 million for the year 1986 and $3.0 million per year thereafter.

Investment income, primarily the result of profit realized from the sale of marketable securities, was $2.1 million in 1985 as compared to $1.7 million in 1984.

Oilfield construction revenue from Numac's wholly-owned subsidiary, McGregor Johanson Contracting Ltd., increased to $4.4 million in 1985 from $2.4 million in 1984. This 83% improvement resulted from increased exploration and development activity in Alberta.

Expenses

Total expenses from continuing operations, exclusive of royalties and taxes, were $30.5 million, an increase of 25% over the $24.4 million incurred in 1984.

Operating expenses were $11.2 million, an increase of 38% over the $8.1 million incurred in 1984. This increase is primarily attributable to increased trucking costs associated with substantially higher production volumes from areas not tied-in to a pipeline.

In May, 1985, Numac finalized a financing agreement commonly referred to as a "production carve-out". Primarily as a result of this transaction, income taxes decreased to $8.6 million in 1985 as compared to $9.9 million in 1984 and PGRT expense decreased to $4.4 million as compared to $6.0 million the previous year. This financing transaction will continue to have positive effects on both income taxes and PGRT expense in 1986 and 1987.

During 1985, the federal government announced the phase out of PGRT, which tax was assessed at the rate of 12% during 1985 on the selling price of oil and gas after deducting lifting costs. This tax will be assessed at the rates of 10%, 8% and 6% during 1986, 1987 and 1988, respectively, and will be completely eliminated in 1989. In addition, PGRT does not apply to production from wells drilled after April 1, 1985 which has the effect of significantly improving cash flow netbacks on new production.

Notwithstanding an increase in production volumes, royalty expense declined by $1.9 million from $16.5 million in 1984 to $14.6 million in 1985. This decrease is primarily attributable to an increase in oil production which is exempt from royalties pursuant to Alberta royalty holiday programs and, to a lesser degree, a reduction in selling prices. In addition, the Alberta government announced a 5% reduction of marginal royalty rates to be phased in over a two-year period commencing August 1, 1985.

We refer you to the Overview section of this report for a discussion of the effects of royalty holidays and removal of PGRT from new oil production, the effect of which is to significantly improve cash flow netbacks.

Depletion and depreciation expenses increased by 10.3% to $11.3 million in 1985 from $10.2 million in 1984. Depletion expense increased by 8.7% to $8.4 million as a result of the combined effect of increased crude oil production and additional exploration spending. Depreciation expense increased by 14.9% to $2.9 million due to additional investment in production facilities in the past twelve months.

General and administration expenses increased by $398,000 to $2,050,000 in 1985 as compared to $1,651,000 in 1984. The increase is primarily due to additions to staff in 1985 and the annualized effect of staff additions made during 1984. Capitalized general and administration expense, which is calculated as a portion of overhead related to oil and gas exploration activities, was $1,886,000 in 1985 as compared to $1,566,000 in 1984.

Earnings

Earnings from continuing operations increased from $14.7 million in 1984 to $17.6 million in 1985, an increase of 19.7%. This increase is primarily due to increased crude oil production and a reduction in taxes as a result of the production carve-out transaction referred to earlier.

The loss on discontinued operations amounted to $1.5 million in 1985 as compared to $12.6 million in 1984 and $.3 million in 1983. These losses are directly attributable to the annual operations of Numac Oil & Gas Inc. which, as previously mentioned, was sold on December 30, 1985.

During 1985, the Company had an extraordinary item due to the sale of Numac Oil & Gas Inc. The sale resulted in a capital loss of $5.8 million which reduced net earnings to $10.3 million.

Capital Expenditures

Gross capital expenditures, before deduction of Petroleum Incentive Program (PIP) payments, amounted to $49.1 million in 1985 as compared to $50.2 million in 1984. Capital expenditures in Canada accounted for 96.2% of the 1985 total. Numac's entitlement to PIP payments in 1985 is approximately $8.6 million, based on eligible capital expenditures of $33.0 million. The Company will continue to qualify for maximum PIP payments until March 31, 1986 at which time the program will expire.

Future capital expenditures will be exclusively in Canada as the Company continues to concentrate primarily on its exploration and development opportunities in Alberta.

Interest capitalized in 1985 amounted to $762,800 and related to oil and gas projects under development which did not contribute to earnings during the year but which are expected to do so in the future. Interest capitalized in 1984 was $823,000 and related to the Company's investment in mining properties.

Shareholders' Equity

Shareholders' equity increased by 7.7% to $138.7 million as at December 31, 1985 as compared to $128.8 million as at December 31, 1984. This increase is primarily attributable to 1985 net earnings of $10.3 million.

Long-term debt was reduced by $6.0 million to $44.8 million at year end with the result that the Company's long-term debt to shareholders' equity ratio was .32 to 1 as compared to .39 to 1 at December 31, 1984.

Liquidity

The Company's bank lines of credit were $55 million at December 31, 1985. These bank lines of credit exceeded amounts drawn at year end by approximately $27 million. At December 31, 1985 the Company's long-term debt pursuant to the production carve-out transaction was $16.8 million.

Numac's working capital increased by $2.9 million during the year to $8.9 million at December 31, 1985.

Cash flow from continuing operations, before interest expense, was 6.3 times total interest costs as compared to 7.5 times in 1984. The reduction of the Company's debt servicing ratio is directly attributable to increased interest costs payable pursuant to the production carve-out transaction referred to earlier but which costs are more than offset by the reduction in income taxes and PGRT expense resulting from the transaction.

Management's policy is to fund 1986 capital expenditures from internally generated sources of funds. In view of the recent volatility and uncertainties relating to world oil prices, capital expenditures will be closely monitored with a view to achieving this objective.

CONSOLIDATED STATEMENT OF EARNINGS

For the year ended December 31

	1985	1984	1983
Revenue			
Operating revenue	**$70,449,531**	$67,098,035	$42,666,316
Investment income and gains	**2,100,007**	1,715,806	2,318,826
Supervision and sundry	**1,118,323**	626,299	647,593
Other	**12,169**	127,308	6,523
	73,680,030	69,567,448	45,639,258
Expense			
Royalties	**14,606,740**	16,522,093	9,797,290
Alberta royalty tax credit	**(2,000,000)**	(2,000,000)	(4,000,000)
Petroleum and gas revenue tax	**4,356,194**	6,001,359	3,590,433
Operating	**11,194,562**	8,083,312	6,029,742
General and administration	**2,049,568**	1,651,184	1,542,617
Interest on long-term debt (net of $762,800 capitalized; 1984 — $823,000)	**5,564,015**	3,966,884	2,326,754
Other interest	**432,189**	459,698	449,797
Depletion and depreciation	**11,290,791**	10,235,259	7,010,257
	47,494,059	44,919,789	26,746,890
Earnings from continuing operations before income taxes	**26,185,971**	24,647,659	18,892,368
Income taxes (Note 9)	**8,587,338**	9,944,050	6,062,011
Earnings From Continuing Operations	**17,598,633**	14,703,609	12,830,357
Loss on discontinued U.S. operations	**1,492,443**	12,633,110	321,372
Earnings Before Extraordinary Item	**16,106,190**	2,070,499	12,508,985
Loss on sale of U.S. operations (Note 10)	**5,824,223**	—	—
Net Earnings	**$10,281,967**	$ 2,070,499	$12,508,985
Per Share			
Earnings from continuing operations	**$0.77**	$0.65	$0.60
Earnings before extraordinary item	**$0.71**	$0.09	$0.58
Net earnings	**$0.45**	$0.09	$0.58

CONSOLIDATED BALANCE SHEET

As at December 31

	1985	1984
ASSETS		
Current Assets		
Marketable securities, at cost (Market value $325,810; 1984 — $3,094,300)	**$ 117,200**	$ 515,700
Receivables (Note 2)	**20,612,172**	19,909,959
Inventories, at lower of cost and net realizable value	**341,271**	387,181
Prepaid expenses and deposits	**1,133,591**	843,714
Total current assets	**22,204,234**	21,656,554
Long-Term Receivables (Note 3)	**4,110,845**	4,111,298
Investments	**121,812**	305,941
Fixed Assets, At Cost (Note 4)		
Oil and gas properties, full cost basis		
Canada	**230,015,799**	198,962,691
United States	**—**	15,284,768
Other	**227,169**	227,169
Mining properties	**7,733,415**	7,863,940
Production and other equipment	**41,346,841**	40,795,515
	279,323,224	263,134,083
Less: Accumulated depletion and depreciation	**50,747,405**	43,532,378
	228,575,819	219,601,705
	$255,012,710	$245,675,498

Approved By The Board

Director

Director

	1985	1984
LIABILITIES		
Current Liabilities		
Bank indebtedness (Note 5)	$ 1,502,855	$ 2,912,752
Accounts payable and accrued	11,782,839	12,692,682
Total current liabilities	13,285,694	15,605,434
Long-Term Debt (Note 6)	44,750,209	50,738,628
Deferred Income Taxes	57,396,056	49,850,061
Advance Gas Payments	852,810	712,894
	116,284,769	116,907,017
Contingency (Note 7)		
SHAREHOLDERS' EQUITY		
Share Capital (Note 8)		
Authorized		
80,000,000 common shares without par value		
8,000,000 preferred shares with par value of $25 each		
Issued and fully paid		
22,743,515 common shares — (1984 — 22,728,440)	82,280,233	82,184,129
Foreign Exchange Translation Gain	—	418,611
Retained Earnings		
Beginning of year	46,165,741	44,095,242
Earnings for the year	10,281,967	2,070,499
End of year	56,447,708	46,165,741
	138,727,941	128,768,481
	$255,012,710	$245,675,498

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

For the year ended December 31

	1985	1984	1983
Operating Activities			
Earnings before extraordinary items	**$16,106,190**	$ 2,070,499	$12,508,985
Items not involving cash			
Depletion and depreciation	**11,290,791**	10,235,259	7,010,257
Deferred income taxes	**7,847,338**	9,944,050	6,062,011
Loss on discontinued operations	**1,492,443**	12,633,110	321,372
Other	**(12,169)**	(127,308)	(6,523)
Cash flow from continuing operations	**36,724,593**	34,755,610	25,896,102
Net change in non-cash working capital balances	**(1,934,769)**	(1,765,113)	(300,048)
Cash flow from continuing operations after working capital changes	**34,789,824**	32,990,497	25,596,054
Loss from discontinued operations	**(1,492,443)**	(12,633,110)	(321,372)
Items not involving cash			
Depletion, depreciation and impairment	**2,297,121**	12,969,978	635,795
	804,678	336,868	314,423
Net change in non-cash working capital balances	**477,246**	(246,865)	63,676
Cash flow from discontinued operations	**1,281,924**	90,003	378,099
Cash flow from operations available for investment	**36,071,748**	33,080,500	25,974,153
Investing Activities			
Acquisition of resource properties	**(44,100,424)**	(39,772,421)	(33,738,714)
Acquisition of plant and equipment	**(5,011,273)**	(10,416,811)	(9,861,854)
Sale of equipment and mining properties	**161,625**	259,500	26,175
Petroleum and other incentive payments	**11,124,373**	8,551,965	9,139,206
Sale of U.S. subsidiary (Note 10)	**7,789,285**	—	—
Other	**1,266,878**	1,102,112	581,533
Cash used in investing activities	**(28,769,536)**	(40,275,655)	(33,853,654)
Cash (deficiency) before financing activities	**7,302,212**	(7,195,155)	(7,879,501)
Financing Activities			
Borrowing (repayment) of long term debt — net	**(5,988,419)**	5,863,318	(16,511,186)
Issue of common shares	**96,104**	—	23,375,000
Cash provided (used) by financing activities	**(5,892,315)**	5,863,318	6,863,814
Increase (decrease) in cash	**1,409,897**	(1,331,837)	(1,015,687)
Bank indebtedness at beginning of year	**(2,912,752)**	(1,580,915)	(565,228)
Bank indebtedness at end of year	**$(1,502,855)**	$(2,912,752)	$(1,580,915)

The 1985 Consolidated Statement of Changes in Financial Position focuses on changes in cash and cash equivalents pursuant to CICA recommendations. Accordingly, the 1984 and 1983 comparative figures have been presented to conform to the 1985 presentation.

SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada which do not differ materially from those established in the United States except where specifically referred to in these notes. Due to the nature of the Company's operations, certain estimates are involved in the preparation of such statements. In Management's opinion, the financial statements have been prepared within reasonable limits of materiality and within the framework of the significant accounting policies as summarized below:

(a) Principles of Consolidation

The consolidated financial statements include the accounts of all wholly-owned subsidiaries of the Company. All significant intercompany balances and transactions have been eliminated.

(b) Oil and Gas Properties

The Company follows the full cost method of accounting prescribed by the United States Securities and Exchange Commission. Under this method all exploration and development costs are accumulated in active cost centres on a country-by-country basis as follows:

1. Canada
2. United States

Costs accumulated in the cost centres are depleted using the unit-of-production method based upon estimated proven reserves. Petroleum Incentive Payments, investment tax credits and other Government incentives are applied against the cost of Canadian oil and gas properties.

(c) Mining

Acquisition and exploration costs of mining properties are capitalized and will be depleted on a unit-of-production basis when production commences.

(d) Depreciation

Depreciation is provided on the straight-line method based on the estimated useful life of equipment as follows:

Production equipment at 7%
Construction and other equipment at 10% to 20%
Roads at 10%

(e) Income Taxes

The Company follows the tax allocation method of accounting for income taxes. Under this method, deferred income taxes are recorded to the extent that income taxes, otherwise payable, are deferred by claiming capital cost allowances and exploration and development costs in excess of the depletion and depreciation provisions.

(f) Foreign Currency Translation

Foreign account balances have been translated to Canadian dollars as follows:

(1) Assets and liabilities at the rate of exchange prevailing at the year end.
(2) Revenues and expenses at a weighted average rate for the year.

(g) Capitalization of Interest

The Company capitalizes interest on unusually significant investments in unproved oil and gas properties and mining projects on which exploration and development activities are in progress but which are not currently amortized and from which no production revenues are currently being earned.

AUDITORS' REPORT

To the Shareholders of
Numac Oil & Gas Ltd.

We have examined the consolidated balance sheets of Numac Oil & Gas Ltd. as at December 31, 1985 and 1984 and the consolidated statements of earnings and of changes in financial position for each of the three years in the period ended December 31, 1985. Our examinations were made in accordance with auditing standards generally accepted in Canada, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1985 and 1984 and the results of its operations and the changes in its financial position for each of the three years in the period ended December 31, 1985 in accordance with accounting principles generally accepted in Canada applied, except for the change, with which we concur in 1985, in the method of accounting for investment tax credits as explained in Note 1 to the financial statements, on a consistent basis.

Deloitte Haskins & Sells
Chartered Accountants

EDMONTON, Alberta
March 5, 1986

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 1
Change in Accounting Policy — Investment Tax Credits

Effective January 1, 1985, the Company changed its method of accounting for investment tax credits by adopting prospectively the new recommendations of the Canadian Institute of Chartered Accountants. Under this method, investment tax credits relating to the acquisition of fixed assets are recorded as a deduction from the cost of the assets in the year that the qualifying expenditures are made, provided there is a reasonable assurance that they will be realized. In previous years the Company used the flow through method of accounting for investment tax credits, whereby the income tax provision was reduced, resulting in a lower effective tax rate. The effect of the change in accounting policy is to decrease earnings in 1985 by $485,000 ($0.02 per share).

Note 2
Receivables

	1985	1984
Trade	**$13,228,182**	$11,638,691
Petroleum incentive payments	**7,110,418**	8,041,437
Alberta royalty tax credit	**169,863**	169,399
Alberta drilling incentives	**103,709**	60,432
	$20,612,172	$19,909,959

Note 3
Long-Term Receivables

	1985	1984
Receivable under the Key Employee Stock Purchase Plan (Note 8 (a))	**$ 3,990,957**	$ 3,990,957
Other	**119,888**	120,341
	$ 4,110,845	$ 4,111,298

Note 4
Fixed Assets

	1985			1984		
	Cost	Accumulated Depletion and Depreciation	Net Book Value	Cost	Accumulated Depletion and Depreciation	Net Book Value
	(Thousands of dollars)					
Oil and gas properties						
Canada	**$230,016**	**$ 38,233**	**$191,783**	$198,962	$ 29,868	$169,094
United States	**—**	**—**	**—**	15,285	3,417	11,868
Other	**227**	**227**	**—**	227	227	—
	230,243	**38,460**	**191,783**	214,474	33,512	180,962
Mining properties	**7,733**	**—**	**7,733**	7,864	—	7,864
Production and other equipment	**41,347**	**12,287**	**29,060**	40,796	10,020	30,776
	$279,323	**$ 50,747**	**$228,576**	$263,134	$ 43,532	$219,602

Costs associated with the acquisition and evaluation of unproved properties excluded from the depletion calculation during the year are $23,012,313 (1984 — $17,424,159). These costs were incurred in the following categories and periods:

	Total	1985	1984	1983 and Prior
Acquisition costs	**$16,730,215**	$ 7,514,270	$4,522,056	$4,693,889
Exploration costs	**5,911,098**	5,836,098	75,000	—
Interest capitalized	**371,000**	371,000	—	—
	$23,012,313	$13,721,368	$4,597,056	$4,693,889

Note 5
Bank Indebtedness

	1985	1984
Current account — net	**$1,502,855**	$1,321,752
Operating loans	**—**	1,591,000
	$1,502,855	$2,912,752

The maximum month end amount of short-term bank loans outstanding during the year was $7,052,000 and the average was $2,283,667. The weighted average interest rate on the bank loans during the year was 10.56% compared to 11.81% in 1984, based on month end balances and interest rates.

At December 31, 1985 the Company had consolidated short-term usable bank lines of credit totalling $15,000,000 with interest at the bank prime rate.

Note 6
Long-Term Debt

	1985	1984
Term bank loan — Canadian	**$28,000,000**	$47,856,000
— U.S.	**—**	2,882,628
Production loan	**16,750,209**	—
	$44,750,209	$50,738,628

The unsecured 1985 term bank loan represents the outstanding portion of a $40,000,000 usable Canadian line of credit. A standby fee of ¼% on the unused portion of this line is payable. The terms of the loan prescribe the minimum levels for consolidated tangible net worth and present value of unencumbered proven Canadian oil and gas reserves to be maintained by the Company. The loan is repayable in twenty equal quarterly instalments commencing January 31, 1988.

The term bank loan is at the lending bank's prime rate or at the option of the Company ½% over the London Interbank Offer Rate (LIBOR) or at ½% above the interest rate on Canadian Bankers' Acceptance notes.

In May 1985 the Company entered into a production loan agreement (commonly called a "Carve-Out") whereby the production from certain properties is applied against the loan. Payments vary with quantity and prices paid for the production. It is presently anticipated the loan will be repaid in full in 1987 or 1988 depending primarily on oil prices. For accounting purposes the net production income earned on these properties continues to form part of the operations of the company.

Note 7
Contingency

A Statement of Claim was filed February 19, 1982, by an Indian Band and certain individual Plaintiffs against the Province of Alberta, Norcen Energy Resources Limited, Dome Petroleum Limited, Chieftain Development Co. Ltd., Shell Canada Limited, Shell Canada Resources Limited, Union Oil Company of Canada Limited, Numac Oil & Gas Ltd. (Numac), Petro-Canada Exploration Inc., Chevron Standard Limited, Petrofina Canada Limited and Amoco Canada Petroleum Company Ltd. The Plaintiffs are claiming Indian Title, aboriginal rights and personal and usufructuary rights (which they claim include the exclusive use and enjoyment of minerals and natural resources) in an area of land in Northern Alberta in which the Province of Alberta has granted oil and gas leases. The Plaintiffs are claiming seven hundred million dollars in lieu of royalties and revenues to date, two hundred million dollars in damages, a declaration that the leases are null and void, and other corollary relief.

The Defendants, including Numac, dispute the claim and on March 31, 1982, Numac and certain of the other Defendants filed a Statement of Defence to the claim. Subsequently, the Plaintiffs applied for an interim injunction to restrain the Defendants from carrying out exploration and production operations in the area until the trial of the action. The injunction application was dismissed by the Alberta Court of Queen's Bench and, in January, 1985, the Court of Appeal dismissed the appeal of the Plaintiffs against the decision of the Court of Queen's Bench dismissing the Plaintiffs' application for an interim injunction. On February 18, 1985, the Plaintiffs applied to the Supreme Court of Canada for leave to appeal from the decision of the Court of Appeal of Alberta. The Supreme Court of Canada, on March 14, 1985, refused the Plaintiffs' application for leave to appeal. On April 9, 1985, the Plaintiffs applied for a rehearing of their Motion for Leave to Appeal. On May 13, 1985, the Court held it did not have jurisdiction to rehear the Plaintiffs' application.

The case is still at an early stage, but based on a preliminary consideration of the claim, Counsel for Numac consider it unlikely that the Plaintiffs will succeed in obtaining any form of relief which will be materially adverse to the interests of the oil companies named as Defendants.

A similar claim was previously advanced against Her Majesty the Queen in right of the Province of Alberta, Her Majesty the Queen in right of Canada and several oil companies, including Numac, in the Federal Court of Canada, but was dismissed as against all Defendants except for Her Majesty the Queen in right of Canada, because of lack of jurisdiction in the Federal Court of Canada.

The Company has approximately two hundred and fifty-four thousand net acres in the area affected by the claim, containing approximately 8% of its proved natural gas reserves and approximately 80% of its proved conventional crude oil reserves.

Note 8 Share Capital

(a) Key Employee Stock Purchase Plan

Under the Key Employee Stock Purchase Plan ("the Purchase Plan"), the Company has agreed to advance funds to a Trustee to be used by the Trustee for the purchase and immediate sale to key employees of common shares of the Company's capital stock at the average sale price of the Company's common shares on the day immediately preceding the transaction.

At December 31, 1985 and 1984, $3,990,957 was receivable by the Company under the Purchase Plan and is included in "Long-Term Receivables" (Note 3). The shares allocated under the Purchase Plan are held as security for the loans. The loans must be repaid in full in 1988 and 1990. The key employee stock purchase loans do not bear interest.

(b) Key Employee Stock Option Incentive Plan

On June 24th, 1982 the Board of Directors approved and adopted the Key Employee Stock Option Incentive Plan ("the Plan") under which the Board of Directors has authority to grant to full time employees of the Company and its subsidiaries, options to purchase shares of common stock of the Company. A total of 930,000 shares of common stock are available and reserved for issuance under this Plan.

Under the Plan, the option price is required to be fixed by the Board of Directors, on the date of each grant but may not be less than 90% of the last reported selling price for the common shares on The Toronto Stock Exchange on the date of the grant. Options granted under the Plan may extend for such periods not to exceed 10 years, all as determined by the Board of Directors, but in each case, may be exercised only for so long as the optionee remains an employee of the company, except in the case of death. Options granted under the Plan may be exercised cumulatively and are not transferable. Options may provide for the giving of, or arranging for financial assistance to an optionee for the purpose of enabling him to pay the exercise price of an option. The Plan does not contain any limitation on the number of options for common shares which may be granted to any one person.

A summary of changes in shares under option during the three years ended December 31, 1985 are as follows (adjusted for the November 1983 two-for-one stock split):

	1985	1984	1983
Shares under option at beginning of period	**723,700**	692,000	631,000
Share options granted at exercise prices of			
— $12.75	**15,000**	—	—
— $12.12 - $14.62	—	40,000	—
— $ 9.25 - $11.25	—	—	76,000
Less			
Share options exercised	**15,075**	8,300	1,876
Share options cancelled	—	—	13,124
Shares under option at end of period	**723,625**	723,700	692,000
Shares under option to officers	**360,000**	360,000	360,000

(c) Continuance

Effective February 25, 1985 the Company was continued under the Business Corporations Act of Alberta.

Note 9
Income Taxes

The following schedule shows the main differences between the combined Canadian Federal and Provincial statutory tax rate and the effective tax rate. Income taxes are calculated on earnings from continuing operations which amount to $26,185,971 in 1985 ($24,647,659 in 1984; $18,892,368 in 1983).

	1985		1984		1983	
	Amount	**%**	Amount	%	Amount	%
			(Thousands of dollars)			
Provision for income taxes at statutory rates	**$12,543**	**47.9**	$11,585	47.0	$ 8,880	47.0
Add (deduct) the tax effect of:						
Production loan (Note 6)	**(5,371)**	**(20.5)**	—	—	—	—
Non-deductible crown royalties and other provincial adjustments	**6,648**	**25.4**	7,448	30.2	4,412	23.4
Non-deductible Petroleum and Gas Revenue Tax	**2,766**	**10.6**	2,821	11.4	1,665	8.8
Alberta royalty tax credit	**(958)**	**(3.7)**	(940)	(3.8)	(1,880)	(10.0)
Resource allowance	**(4,441)**	**(17.0)**	(6,213)	(25.2)	(3,798)	(20.1)
Depletion allowance	**(2,062)**	**(7.8)**	(3,757)	(15.2)	(2,215)	(11.7)
Other	**(538)**	**(2.1)**	(1,000)	(4.1)	(1,002)	(5.3)
Effective income taxes	**$ 8,587**	**32.8**	$ 9,944	40.3	$ 6,062	32.1

The Company has a net capital loss carried forward of approximately $19,400,000, the potential benefit of which has not been reflected in the financial statements.

Note 10
Loss on Sale of U.S. Operations

On December 30, 1985 the Company sold its wholly-owned subsidiary Numac Oil & Gas Inc. for net proceeds of $7,789,285. This represents a discontinuance of the Company's United States operations.

Under United States generally accepted accounting principles, the loss on sale of U.S. Operations would not be regarded as an extraordinary item. The loss on sale of U.S. operations of $5,824,223 is net of $367,000 of deferred and $460,000 of current income taxes recovered.

Note 11
Remuneration of Senior Officers and Directors

The remuneration paid to senior officers of the Company in 1985 amounted to $873,118 (1984 — $818,647; 1983 — $782,942) and directors' fees amounted to $32,000 (1984 — $28,000; 1983 — $23,500).

Note 12
Segmented Information

The Company sold its U.S. resources development segment in 1985 and therefore the financial information presented below reflects only the following Canadian business segments.

A. Resource development — Canada
B. Oilfield construction — Canada

	A	**B**	**Eliminations**	**Consolidated**
		(Thousands of dollars)		
Year Ended December 31, 1985				
Operating revenue	**$ 67,319**	**$ 6,136**	**$ (1,887)**	**$ 71,568**
Gain on sale of fixed assets	**—**	**12**	**—**	**12**
Investment income	**2,100**	**—**	**—**	**2,100**
Total revenue	**$ 69,419**	**$ 6,148**	**$ (1,887)**	**$ 73,680**
Operating profit	**$ 25,132**	**$ 1,494**	**$ (440)**	**$ 26,186**
Total assets	**255,160**	**2,144**	**(2,291)**	**255,013**
Depletion and depreciation	**10,849**	**442**	**—**	**11,291**
Capital expenditures (net)	**36,690**	**34**	**(619)**	**36,105**

	A	B	Eliminations	Consolidated
Year Ended December 31, 1984				
Operating revenue	$ 65,853	$ 5,050	$ (3,180)	$ 67,723
Gain on sale of fixed assets	—	128	—	128
Investment income	1,716	—	—	1,716
Total revenue	$ 67,569	$ 5,178	$ (3,180)	$ 69,567
Operating profit	$ 24,113	$ 1,440	$ (905)	$ 24,648
Total assets	276,749	1,593	(49,201)	229,141
Depletion and depreciation	9,768	467	—	10,235
Capital expenditures (net)	37,811	978	(427)	38,362

	A	B	Eliminations	Consolidated
Year Ended December 31, 1983				
Operating revenue	$ 40,743	$ 5,471	$ (2,899)	$ 43,315
Gain on sale of fixed assets	—	6	—	6
Investment income	2,318	—	—	2,318
Total revenue	$ 43,061	$ 5,477	$ (2,899)	$ 45,639
Operating profit	$ 18,022	$ 1,504	$ (634)	$ 18,892
Total assets	240,033	5,096	(44,697)	200,432
Depletion and depreciation	6,611	399	—	7,010
Capital expenditures (net)	30,012	108	(634)	29,486

Note 13
Related Party Information

Numac Oil & Gas Ltd. ("Numac"), participates in oil and gas exploration and development ventures in Alberta with Union Shield Resources Ltd. ("Union Shield") a wholly-owned subsidiary of Union Enterprises Ltd. Union Shield, at March 1, 1986, beneficially owns 22.99% of the outstanding shares of Numac's common stock. From January 1, to December 31, 1985, Numac invoiced Union Shield for $182,999 ($182,817 in 1984) for exploration and development expenditures. W. Darcy McKeough is a director of Union Enterprises Ltd. and is a director of Numac and owns 2,000 shares of Numac.

Numac's wholly-owned subsidiary, Numac Oil & Gas Inc. ("Inc.") participated in oil and gas exploration and development joint ventures in the United States with Shield Resources, Inc., a wholly-owned subsidiary of Precambrian Shield Resources Limited ("Precambrian"). At March 1, 1986, Union Shield beneficially owned 66.12% of Precambrian. Stewart D. McGregor, a director of Numac, is a director of Precambrian and owns 9,300 shares of Precambrian. Numac sold its interest in Inc. on December 30, 1985.

Numac entered into an agreement in July, 1985, with PitCan Resources Limited ("PitCan") to participate in oil and gas exploration and development activities in Canada. PitCan is a wholly-owned subsidiary of Parkway Investments Inc. which is a wholly-owned subsidiary of The Pitcairn Company ("Pitcairn"). Pitcairn at March 1, 1986, beneficially owned 7.91% of Numac. Jack W. Robbins, a director of Numac, is Vice-Chairman of Pitcairn Incorporated, a wholly-owned subsidiary of Pitcairn. Pursuant to the agreement, Numac invoiced PitCan $292,263 in January, 1986, for the acquisition of oil and gas properties.

For legal services rendered during 1984, the Company paid the law firm of Jackson, Arlette, MacIver and Skitsko of Edmonton, Alberta the sum of $14,971. Alex N. MacIver, is a partner of the said law firm and is a director of the Company.

Note 14
World Oil Prices

The Company's revenue from oil and gas producing activities are dependent upon world oil prices. Subsequent to the year-end the world oil price has declined significantly. Because of the many factors that effect the world price of oil, it is difficult at the present time to determine whether the recent declines are of a temporary or a long-term nature. Accordingly, it is not possible at this time to assess the effect, if any, the current decline in the world price of oil will have on the Company.

Note 15
Comparative Figures

Certain of the prior years' comparative figures have been reclassified to conform to the current year's presentation.

Supplementary Information (Unaudited)

Estimated Quantities of Proved Oil and Gas Reserves Net of Royalties

Both the Canadian Institute of Chartered Accountants (CICA) and the Financial Accounting Standards Board (FASB) recommend supplementary disclosure with respect to oil and gas reserves. The following information is prepared in accordance with the CICA recommendations, which closely parallel the guidelines issued by the FASB in its Statement No. 69.

Crude oil, including natural gas liquids, is expressed in thousands of barrels. Natural gas is expressed in millions of cubic feet. The quantities below represent net reserves owned by Numac after deduction of royalties.

	TOTAL		CANADA		UNITED STATES	
	OIL	GAS	OIL	GAS	OIL	GAS
Net proved developed and undeveloped reserves						
At January 1, 1983	7,399	128,872	7,101	119,888	298	8,984
Revisions of previous estimate	180	(7,004)	157	(7,035)	24	31
Extensions, discoveries and other additions	2,257	6,150	2,167	5,658	89	492
Production	(810)	(2,600)	(745)	(2,088)	(65)	(512)
At December 31, 1983	9,026	125,418	8,680	116,423	346	8,995
Revisions of previous estimate	(673)	(2,618)	(634)	2,148	(39)	(4,766)
Extensions, discoveries and other additions	2,248	2,302	2,248	2,302	—	—
Production	(1,200)	(2,661)	(1,143)	(2,514)	(57)	(147)
At December 31, 1984	9,401	122,441	9,151	118,359	250	4,082
Revisions of previous estimate	**91**	**6,007**	**116**	**8,864**	**(25)**	**(2,857)**
Extensions, discoveries and other additions	**1,773**	**5,720**	**1,773**	**5,720**	**—**	**—**
Production	**(1,275)**	**(2,612)**	**(1,238)**	**(2,442)**	**(37)**	**(170)**
Sale of reserves in place	**(188)**	**(1,055)**	**—**	**—**	**(188)**	**(1,055)**
At December 31, 1985	**9,802**	**130,501**	**9,802**	**130,501**	**—**	**—**
Net proved developed reserves						
At December 31, 1983	8,283	116,784	7,937	107,789	346	8,995
At December 31, 1984	8,658	113,808	8,408	109,726	250	4,082
At December 31, 1985	**8,894**	**118,656**	**8,894**	**118,656**	**—**	**—**

The Canadian oil and gas reserve information was compiled by the Company's independent petroleum consultants, McDaniel & Associates Consultants Ltd. using an average price of $34.57 per barrel of crude oil. The United States reserve information is based on reports by various U.S. independent petroleum consultants. All independent reserve studies were reviewed by the Company's engineering staff. Proved reserves cannot be measured exactly and therefore all reserve estimates may be subject to revision.

Total oil reserves at December 31, 1985 before royalties were estimated to be 12,476 thousand barrels (1984 — 12,221). The total gas reserves before royalties were estimated to be 162,569 million cubic feet (1984 — 155,286).

Proved reserves are those quantities of crude oil, natural gas liquids and natural gas which geological and engineering data indicate with reasonable certainty are recoverable in the future from known reservoirs under existing economic and operating conditions.

Proved developed reserves are defined to be those which can be expected to be recovered from existing wells, equipment and operating methods. Proved undeveloped reserves are those that are expected to be recovered from new wells on undrilled acreage or from existing wells where a relatively major expenditure is required for recompletion.

The figures presented are believed to be reasonable estimates of reserves which may be expected to be recoverable commercially at current prices and costs under existing regulatory practice and with existing conventional equipment and operating methods.

The following information has been included to comply with United States Securities and Exchange Commission regulations and is presented in accordance with the guidelines issued by the CICA and the FASB in its Statement No. 69.

Costs Incurred in Oil and Gas Property Acquisition, Exploration and Development Activities

	1985	1984	1983
Canada			
Acquisition of oil and gas properties — unproved	**$ 8,108,030**	$ 6,845,717	$ 5,418,330
Exploration costs (net of government incentives)	**13,813,802**	11,951,269	7,812,660
Development costs (net of government incentives)	**9,693,275**	11,361,171	7,680,080
	31,615,107	30,158,157	20,911,070
United States, net of impairment*	**1,881,944**	(9,460,382)	5,664,029
	$33,497,051	$20,697,775	$26,575,099

*Pursuant to the Securities and Exchange Commission's (SEC) accounting rules, the investment in United States oil and gas properties was written down by $11,514,350 in 1984.

Capitalized Costs Relating to Oil and Gas Producing Activities

Thousands of dollars

	Total	Canada	United States	Other
1985				
Unproved oil and gas properties	**$107,874**	**$107,647**	**$ —**	**$ 227**
Proved oil and gas properties	**122,369**	**122,369**	**—**	**—**
Production equipment	**35,245**	**35,245**	**—**	**—**
	265,488	**265,261**	**—**	**227**
Accumulated depreciation, depletion and amortization	**47,709**	**47,482**	**—**	**227**
Net capitalized costs	**$217,779**	**$217,779**	**$ —**	**$ —**
1984				
Unproved oil and gas properties	$ 94,151	$ 91,879	$ 2,045	$ 227
Proved oil and gas properties	120,323	107,083	13,240	—
Production and other equipment	34,632	30,229	4,403	—
	249,106	229,191	19,688	227
Accumulated depreciation, depletion and amortization	40,520	36,297	3,996	227
Net capitalized costs	$208,586	$192,894	$ 15,692	$ —
1983				
Unproved oil and gas properties	$ 95,731	$ 84,030	$ 11,474	$ 227
Proved oil and gas properties	98,209	85,238	12,971	—
Production and other equipment	26,981	24,098	2,883	—
	220,921	193,366	27,328	227
Accumulated depreciation, depletion and amortization	29,300	26,837	2,241	222
Net capitalized costs	$191,621	$166,529	$ 25,087	$ 5

Standardized Measure of Discounted Future Net Cash Flows and Changes therein relating to Proved Oil and Gas Reserves

The following standardized measure was computed using year-end prices, costs, and year-end statutory tax rates. The 10% discount factor is mandated by FASB Statement No. 69.

The future net cash flow information should be interpreted with considerable caution. Reserve estimates, by their very nature, are inexact and are subject to constant revision. Also, the future production streams and future development and production expenditures are unpredictable for numerous reasons including government regulations and are, therefore, subject to significant uncertainty.

It should not be assumed that the estimates of the standardized measure of future net cash flows represent fair market value of the reserves or of the oil and gas properties. Also, because of the year-end price assumptions the standardized measure does not represent the present value of future cash flows.

	TOTAL	CANADA	UNITED STATES
1985			
Future cash inflows	**$808,893**	**$808,893**	**$ —**
Deduct			
Future production and development costs	**164,921**	**164,921**	—
Future income taxes	**183,133**	**183,133**	—
Future revenue taxes	**177,778**	**177,778**	—
	525,832	**525,832**	—
Future net cash flows	**283,061**	**283,061**	—
Deduct			
10% annual discount for estimated timing of cash flows	**141,572**	**141,572**	—
Standardized measure of discounted future net cash flows	**$141,489**	**$141,489**	**$ —**
1984			
Future cash inflows	$822,672	$800,282	$ 22,390
Deduct			
Future production and development costs	167,328	166,711	617
Future income taxes	169,497	169,497	—
Future revenue taxes	262,932	261,142	1,790
	599,757	597,350	2,407
Future net cash flows	222,915	202,932	19,983
Deduct			
10% annual discount for estimated timing of cash flows	104,442	98,313	6,129
Standardized measure of discounted future net cash flows	$118,473	$104,619	$ 13,854

The following are the principal sources of the change in the standardized measure of discounted future net cash flows:

Thousands of dollars

	1985	1984
Beginning of the year	**$118,473**	$123,807
Sales of oil and gas production net of related cost	**(38,571)**	(16,319)
Net change in prices and production costs	**(14,869)**	(16,373)
Net change in estimated future development costs	**6,794**	(1,552)
Extensions and discoveries net of related costs	**29,621**	38,628
Sale of minerals in place	**(6,261)**	—
Revisions of previous quantity estimates	**7,295**	(15,439)
Accretion of discount	**11,847**	12,381
Net change in income taxes	**(6,816)**	(4,326)
Net change in revenue taxes	**33,548**	(3,430)
Other	**428**	1,096
End of year	**$141,489**	$118,473

The Effects of Changing Prices

The Canadian Institute of Chartered Accountants (CICA) and the Financial Accounting Standards Board (FASB) recommend supplementary disclosure of the effects of changing prices on the operations of the Company. Both of these accounting authorities have realized there are special problems related to the determination of current cost information for the oil and gas industry.

The Company has decided not to disclose supplementary information on the effects of changing prices. The CICA Research Study released in February, 1985 revealed that the majority of Canadian oil and gas companies provided no supplementary information.

Results of Operations for Producing Activities — Canada

For the year ended December 31

Thousands of dollars

	1985	1984	1983
Operating revenues	**$66,141**	$63,812	$40,742
Deduct			
Royalties	**14,607**	16,522	9,797
Royalty tax credit	**(2,000)**	(2,000)	(4,000)
Production costs	**8,666**	6,921	5,234
Depreciation, depletion and amortization	**10,506**	9,464	6,591
Income tax expense	**7,275**	10,085	6,709
Petroleum and Gas Revenue Tax	**4,356**	6,001	3,590
	43,410	46,993	27,921
Results of operations from producing activities	**$22,731**	$16,819	$12,821

The above revenues and costs exclude items which are not directly related to producing activities.

Selected Quarterly Financial Information

Thousands of dollars except per share amounts

	QUARTER ENDED				
	March 31	**June 30**	**Sept 30**	**Dec 31**	**Total Year**
Year Ended December 31, 1985					
Revenue	**$18,794**	**$16,628**	**$17,841**	**$20,417**	**$73,680**
Earnings from continuing operations before taxes	**$ 6,796**	**$ 5,165**	**$ 6,798**	**$ 7,427**	**$26,186**
Earnings from continuing operations	**$ 4,036**	**$ 3,336**	**$ 5,680**	**$ 4,547**	**$17,599**
Earnings before extraordinary item	**$ 3,813**	**$ 3,414**	**$ 5,651**	**$ 3,228**	**$16,106**
Net Earnings	**$ 3,813**	**$ 3,414**	**$ 5,651**	**$ (2,596)**	**$10,282**
Per Share					
Earnings from continuing operations	**$ 0.18**	**$ 0.15**	**$ 0.25**	**$ 0.19**	**$ 0.77**
Earnings before extraordinary item	**$ 0.17**	**$ 0.15**	**$ 0.25**	**$ 0.14**	**$ 0.71**
Net Earnings	**$ 0.17**	**$ 0.15**	**$ 0.25**	**$ (0.12)**	**$ 0.45**
Year ended December 31, 1984					
Revenue	$16,871	$14,364	$19,409	$18,923	$69,567
Earnings from continuing operations before taxes	$ 5,624	$ 5,363	$ 6,496	$ 7,165	$24,648
Earnings from continuing operations	$ 3,262	$ 3,497	$ 3,713	$ 4,232	$14,704
Net Earnings	$ 3,310	$ 2,982	$ 3,394	$ (7,616)	$ 2,070
Per Share					
Earnings from continuing operations	$ 0.15	$ 0.15	$ 0.16	$ 0.19	$ 0.65
Net Earnings	$ 0.15	$ 0.13	$ 0.15	$ (0.34)	$ 0.09

The quarterly information has been adjusted as a result of the sale of the U.S. subsidiary.

Currency Exchange Fluctuations

The Canadian dollar has fluctuated in terms of the U.S. dollar throughout 1985 and at March 1, 1986 was equivalent to $0.7035 U.S. The following is a table setting forth equivalent U.S. dollars:

	1985	**1984**	**1983**
March 31	**$0.7334**	$0.7836	$0.8083
June 30	**$0.7360**	$0.7593	$0.8148
September 30	**$0.7277**	$0.7591	$0.8116
December 31	**$0.7152**	$0.7566	$0.8036

Market for Common Stock and Related Security Holder Information

The common shares are listed on the Toronto Stock Exchange and the American Stock Exchange. The following table sets forth the high and low sale prices for the common shares traded on these exchanges.

		Toronto Stock Exchange (Canadian dollars)		**American Stock Exchange (U.S. dollars)**	
Period		**High**	**Low**	**High**	**Low**
1985	1st quarter	**$15.25**	**$12.50**	**$11.50**	**$ 9.00**
	2nd quarter	**15.25**	**11.00**	**11.25**	**8.12**
	3rd quarter	**14.12**	**11.12**	**10.62**	**8.12**
	4th quarter	**14.00**	**11.37**	**10.12**	**8.25**
1984	1st quarter	$15.87	$11.87	$12.50	$ 9.50
	2nd quarter	18.00	14.87	14.25	11.50
	3rd quarter	17.25	13.50	12.87	10.37
	4th quarter	16.87	14.25	12.75	10.62

The Company's 22,743,515 issued common shares were held by approximately 3,300 registered holders at January 1, 1986.

FIVE YEAR REVIEW

Financial

Thousands of dollars except per share amounts

	1985	1984	1983	1982	1981
Revenue					
Oil and gas division	**$67,199**	$65,470	$40,742	$27,769	$20,541
Oilfield construction	**4,381**	2,381	2,578	2,203	3,161
Investment income	**2,100**	1,716	2,319	477	412
	73,680	69,567	45,639	30,449	24,114
Expense					
Royalties (net)	**12,607**	14,522	5,798	2,865	3,350
PGRT and IORT	**4,356**	6,001	3,590	2,780	1,072
Operating	**11,195**	8,083	6,030	3,754	3,537
General and administration	**2,050**	1,651	1,542	975	867
Interest on long-term debt	**5,564**	3,967	2,327	3,957	3,204
Other interest	**432**	460	450	649	908
Depletion and depreciation	**11,291**	10,235	7,010	5,483	3,941
Income taxes	**8,587**	9,944	6,062	2,850	3,084
	56,082	54,863	32,809	23,313	19,963
Earnings From Continuing Operations	**17,598**	14,704	12,830	7,136	4,151
Loss On Discontinued Operations	**(1,492)**	(12,634)	(321)	(4,035)	(15,730)
Earnings Before Extraordinary Items	**16,106**	2,070	12,509	3,101	(11,579)
Extraordinary Items					
Net of tax	**(5,824)**	—	—	9,250	474
Net Earnings	**$10,282**	$ 2,070	$12,509	$12,351	$(11,105)
Per Share (reflects 1983 2-1 stock split)					
Earnings from continuing operations	**$ 0.77**	$ 0.65	$ 0.60	$ 0.36	$ 0.22
Earnings before extraordinary items	**$ 0.71**	$ 0.09	$ 0.58	$ 0.16	$ (0.61)
Net earnings	**$ 0.45**	$ 0.09	$ 0.58	$ 0.63	$ (0.59)
Dividends	**—**	—	—	$ 0.05	$ 0.10
Capital Expenditures	**$ 49,111**	$ 50,189	$ 43,601	$ 49,789	$ 54,815
Total Assets	**$255,013**	$245,675	$226,830	$203,912	$159,710
Long-Term Debt	**$ 44,750**	$ 50,739	$ 44,875	$ 61,386	$ 63,461
Shareholders' Equity	**$138,728**	$128,768	$125,727	$ 89,449	$ 54,847

Operating (Canada)

	1985	1984	1983	1982	1981
Production					
Oil — thousands of barrels	**1,577**	1,495	972	698	545
Gas — millions of cubic feet	**3,042**	3,212	2,427	2,864	2,433
Wells Drilled					
Completed	**78**	89	70	88	60
Abandoned	**58**	38	34	37	29
	136	127	104	125	89

CORPORATE INFORMATION

OFFICERS

William S. McGregor
President and Chief Executive Officer

Donald F. Baker
Vice-President, Engineering

Ronald D. Larmour
Vice-President and Treasurer

Stewart D. McGregor
Executive Vice-President

C. R. S. Montgomery
Vice-President and Secretary

James H. Pletcher
Vice-President, Special Projects

Wilfred J. Wilson
Vice-President, Exploration

DIRECTORS

Hadley Case
Chairman and Chief Executive Officer
Case, Pomeroy & Company, Inc.
New York, N.Y.

Alex N. MacIver
Barrister and Solicitor
Jackson, Arlette, MacIver & Skitsko
Edmonton, Alberta

Stewart D. McGregor
Executive Vice-President
Numac Oil & Gas Ltd.
Edmonton, Alberta

William S. McGregor
President & Chief Executive Officer
Numac Oil & Gas Ltd.
Edmonton, Alberta

W. Darcy McKeough
Chairman
Union Gas Limited
Chatham, Ontario

Jack W. Robbins
Vice Chairman
Pitcairn Incorporated
Jenkintown, PA

Bruce W. Watson
President
Wrangler Resources Ltd.
Calgary, Alberta

HEAD OFFICE

Petroleum Plaza, South Tower
1400, 9915 - 108 Street
Edmonton, Alberta
Canada T5K 2G8
Telephone (403) 423-1718

STOCK EXCHANGE LISTINGS

Toronto Stock Exchange
American Stock Exchange
Stock Symbol: NMC

BANKERS

The Bank of Nova Scotia
Edmonton, Alberta

REGISTRARS AND TRANSFER AGENTS

The Royal Trust Company
Edmonton, Alberta
Montreal, Quebec
Toronto, Ontario

The Canadian Imperial Bank of
Commerce Trust Company
New York, N.Y.

AUDITORS

Deloitte Haskins & Sells
Edmonton, Alberta

SOLICITORS

Jackson, Arlette, MacIver & Skitsko
Edmonton, Alberta

FORM 10-K

Copies of this report and the Annual Report on Form 10-K filed with the Securities and Exchange Commission of the United States of America are available free of charge by writing to the Secretary of the Company, 1400, 9915 - 108 Street, Edmonton, Alberta, Canada T5K 2G8

NUMAC
OIL & GAS LTD.